LACKING SEVERAL ISSUES

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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

September 1986

Highlights of Developments Over the First Half of 1986

- *Growth in the major industrial countries in the first half of 1986 was unexpectedly weak, reflecting the dramatic oil-price developments as well as trade, exchange rate and other imbalances.*
- *Economic growth in Canada slowed in the first half of 1986 from the very rapid pace of the second half of last year, but still was amongst the highest of the major OECD countries.*
- *The Canadian economy was buffeted by sharp, temporary increases in interest rates early this year and by falling world oil and grain prices which depressed profits and incomes and weakened final domestic demand, especially energy investment.*
- *Interest rates have fallen to eight-year lows, substantially reducing financing costs for households and firms.*

Summary

The Canadian economy grew at an average annual rate of 2.6% in the first two quarters of 1986, following a 4.0% increase for 1985 as a whole and a strong 5.2% rise during the second half of last year. A slowdown in the pace of economic expansion from the rapid second-half pace was generally anticipated early in the year, but the nature and extent largely reflects unexpected developments in the international economy: the precipitous declines in world oil and grain prices, large currency fluctuations, and the unanticipated weakness in the three largest industrial countries, the U.S., Japan and Germany.

These unfavourable international developments buffeted the Canadian economy during the first half of this year. In conjunction with the sharp, temporary increases in short-term interest rates associated with the weakness in the Canadian dollar early in the year, they combined to create consumer and investor uncertainty which weakened final domestic demand (Chart 1). Notwithstanding these developments, output continued to grow, initially due to strong inventory investment and, in the second quarter, an improvement in Canada's real net trade position. Developments over the second half of the year will be shaped importantly by both domestic factors and growth prospects elsewhere in the major industrial countries, as well as by the degree of progress made in reducing imbalances in the world economy.

Canada was not the only country to experience slower growth in the first part of this year. Existing trade and fiscal imbalances in the world

Chart 1

Real GDP and Final Domestic Demand

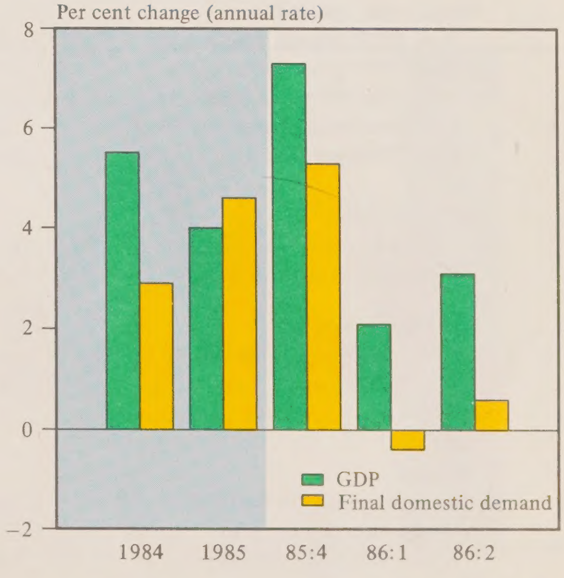

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Chart 2

Output in Canada and Major Trading Partners

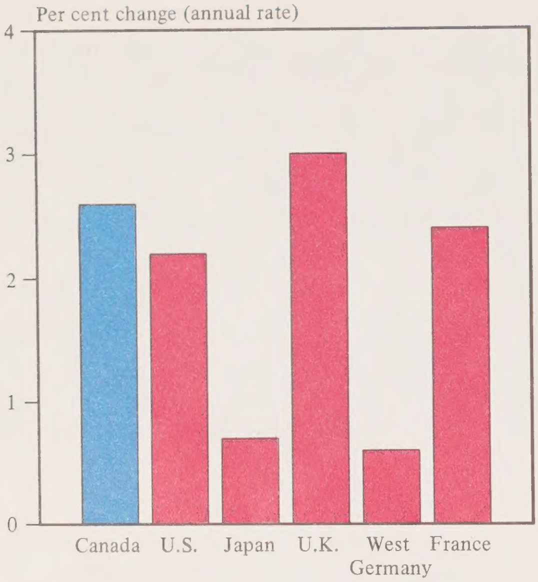
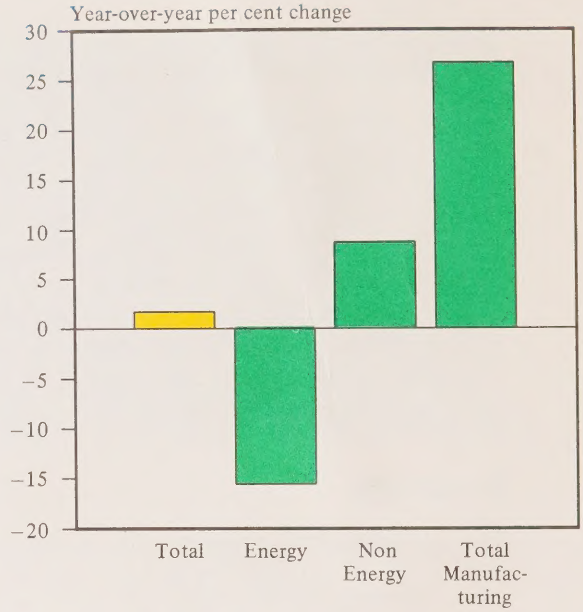


Chart 3

Business Investment Intentions, 1986



Main Economic Indicators

	1984	1985	1985 Q4	1986 Q1	1986 Q2	Latest Data	Period
Output and demand							
Real GDP growth (%, a.r.)	5.5	4.0	7.3	2.1	3.1		
Real GNP growth (%, a.r.)	5.3	4.0	6.2	1.0	4.4		
Real final domestic demand (%, a.r.)	2.9	4.6	5.3	−0.4	0.6		
Manufacturing shipments (%, a.r.)	12.3	7.1	12.7	−2.9	−6.3	−34.5	(June)
Trade balance ($b, a.r.)	20.7	17.5	16.1	9.2	11.7	5.3	(June)
Labour market							
Unemployment rate (%)	11.3	10.5	10.2	9.7	9.6	9.7	(Aug.)
Employment growth (%, a.r.)	2.5	2.8	4.2	6.1	0.8	5.1	(Aug.)
Costs and prices							
Consumer price inflation (%, Y/Y)	4.4	4.0	4.2	4.2	3.9	4.2	(July)
GDP price inflation (%, a.r.)	3.6	3.4	1.6	2.0	1.9		
Unit labour costs (% change, a.r.)	1.9	3.1	−1.6	2.7	0.3		
Financial							
Exchange rate (U.S.$/Can.)	0.772	0.731	0.723	0.707	0.725	0.722	(Sept. 5)
Prime interest rate (%)	12.1	10.58	10.00	12.00	10.58	9.75	(Sept. 5)
1-year mortgage rate (%)	12.0	10.31	9.83	11.17	9.92	9.75	(Sept. 5)

economy coupled with uncertainties engendered by rapidly adjusting exchange rates and large movements in commodity prices markedly slowed first-half growth among Canada's principal trading partners (Chart 2).

Nonetheless, the OECD countries in general should benefit from the decline in oil prices and the drop in interest rates. Growth prospects for these countries over the second half of 1986 and into 1987 are improving markedly; in fact, the OECD currently is forecasting growth in industrial economies to be above potential over the next 12 months.

In this context the economic fundamentals in Canada suggest that the Canadian economy is well-poised to realize substantial benefits from increased world growth. Interest rates and the unemployment rate are lower than they have been for several years. Consumer confidence turned up in the second quarter. The financial positions of the household and corporate sectors are generally healthy. Growth in labour costs and consumer prices are moderate with good prospects for further improvements in Canada's international competitiveness.

Economic Growth Slows in the First Half of the Year

The slowdown in growth during the first half of 1986 reflected weakness in final domestic demand (Chart 1). In the first quarter, both residential construction and consumer spending on goods declined and business non-residential investment was flat. From March onwards, as interest rates fell sharply, consumer expenditure on goods and residential construction rebounded, but were offset as business non-residential investment plummeted due to the collapse of energy investment. A large increase in inventory investment in the first quarter boosted production more than enough to offset a large decline in net exports. The sources of output growth were substantially different in the second quarter with a sharp improvement in real net trade and healthy consumption spending leading the way.

Investment Picture Mixed

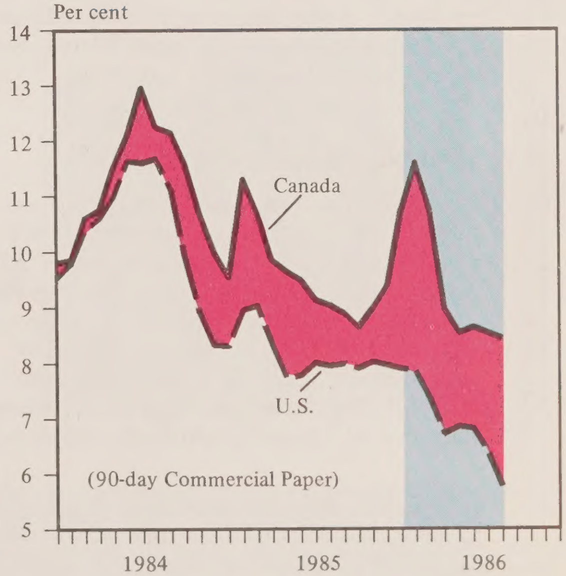
Statistics Canada's Mid-Year Private and Public Investment Intentions survey points to a weak 1.7% growth in nominal investment spending in 1986, due solely to projected large declines in energy investment (Chart 3). In contrast, the survey also projects a healthy 8.7% increase in non-energy investment, with much of the growth concentrated in the manufacturing sector which is expected to register a strong increase of 26.7%. According to the survey, 1986 will be the second year of strong non-energy investment growth. Furthermore, given the extent of investment declines so far in 1986, the PPI survey suggests that total private sector investment should not be a source of weakness over the remainder of the year.

Short-Term Interest Rates Reach Eight-Year Low

Following a sharp run-up early in the year when the Canadian dollar was under temporary pressure (Chart 4), short-term interest rates (90-day Commercial Paper) decreased four percentage points to near 8.5% by May, their lowest level in eight years. The resulting drop in the chartered bank's prime rate to 9.75% on July 18 marks the first time in eight years that this rate has been below 10%. Long-term interest rates (e.g. corporate bond rates) decreased to eight-year lows in the first quarter.

Chart 4

Canadian and U.S. Short-Term Interest Rates



The Economy in Brief

Strong Inventory Accumulation

Over the first half of the year, inventory investment, which has been high by recent historical standards, was an important source of strength for the Canadian economy. Although inventory accumulation will probably ease over the second half of the year, the stock-to-sales ratio, which remains close to its low average value of the last three years, suggests an actual decumulation of inventories is unlikely.

Current Account Deficit Increases Substantially

The current account deficit reached a record level of $11.4 billion (at annual rates) in the first quarter but improved significantly in the second quarter reaching $7.3 billion. The deterioration in the first half of the year was due mainly to the significant erosion in the terms of trade (i.e. low oil and grain prices). Exports were also affected by slower growth in U.S. domestic demand as well as weakness in the growth of some of Canada's major overseas trading partners. Some improvement over the near term in our trade with overseas countries is likely to materialize in response to the significant depreciation of the Canadian dollar against those currencies as well as an expected pick-up in overseas economic activity.

Canadian Dollar Stabilizes

The Canadian dollar, after experiencing downward pressures early in the year that resulted in a record low of U.S. $0.6913 on February 4, rebounded in early March. Since then it has traded around U.S. $0.72.

Inflation Remains Moderate

Consumer price increases during the first seven months of the year remained around 4% (on a year-over-year basis) reaching a low of 3.7% in June before rising to 4.2% in July. Another measure of inflation, the change in the GDP deflator, registered a more modest 2.5% year-over-year increase in the second quarter. Since March, there have been sharp declines in the price of petroleum products. Continued moderate wage settlements and productivity growth augur well for future inflation prospects.

Consumer Confidence Increases

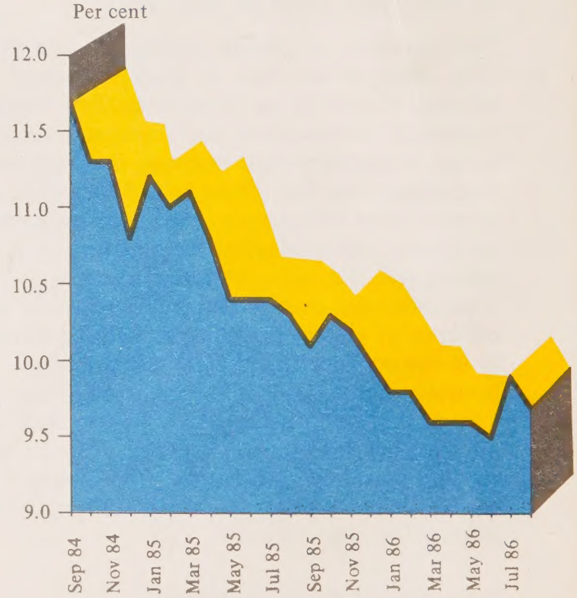
After falling in the first quarter, the Conference Board's Index of Consumer Attitudes rose sharply in the second quarter. Consumer expenditures on goods rebounded in the second quarter and the personal savings rate reached a seven-year low.

Unemployment Rate Averages 9.7% for the First Half of 1986

Despite the large fluctuations experienced since March, employment in August was only slightly below its January record level and still above its year-end levels. For the first eight months of the year, employment levels averaged 3.4% greater than the corresponding period last year. The unemployment rate, which continued to decline over the February-to-June period (Chart 5), increased to 9.9% in July before falling to 9.7% in August, its average since January.

Chart 5

The Unemployment Rate Since September 1984



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

December 1986

Highlights of Developments in the Third Quarter

- *Economic growth (GDP) slowed to 1.2% in the third quarter due to a deterioration in the merchandise trade balance and a decline in real inventory investment, but final domestic demand rebounded sharply after contributing little to growth in the first half of the year.*
- *After two quarters of declines, consumption of durables increased strongly, reflecting in large part a significant strengthening of automobile sales.*
- *Residential building activity was particularly strong with housing starts reaching their highest quarterly level in eight years.*
- *Despite the weakness in output growth in the third quarter, Canada's economy has grown faster than those of its major trading partners over the first three quarters of the year compared to the same period in 1985.*

Summary

Growth in real gross domestic product (GDP), the broadest measure of economic activity, was 1.2% at an annual rate in the third quarter of 1986. This represented a slowing from the 2.8% pace of growth in the first half of this year, with the main sources of weakness being a deterioration in the merchandise trade balance and a decline in real inventory investment.

A key development in the third quarter was the rebound in final domestic demand after two quarters of weakness. Consumer expenditures on durable goods, especially on autos, rebounded while investment in new housing reached levels which had not been seen since the mid-1970s. Consumers continued to feel sufficiently confident in their economic prospects to finance part of their spending through lower savings.

Part of the consumer spending on autos in the third quarter was in response to incentives to buy and, to some extent, probably represented some bringing forward of future spending plans. However, consumer spending on all major categories was strong in the third quarter. The relatively low levels of interest rates, stable inflation, and the generally healthy financial position of households have created a climate of optimism conducive to reductions in the personal savings rate.

Chart 1

Growth in Major OECD Countries, First Three Quarters of 1986

Note: Third quarter data for France are an estimate.

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Financial Market Conditions Stable

Both short- and long-term Canadian interest rates have remained relatively stable over the past six months. During the third quarter, Canadian short-term interest rates fell marginally, narrowing somewhat the uncovered short-term interest rate differential between Canada and the U.S. rates. The differential averaged 230 basis points in early December, significantly below its 1986 high recorded in February, and the Canadian dollar continues to trade in a narrow range around U.S. $0.72.

High Inventory Investment Influenced by Special Factors

Inventory investment was at its highest level in eight years in the first two quarters of 1986, and well above 1985 levels. In the third quarter, inventory investment decreased by just over $2 billion. Grain and gold inventory accumulation has been responsible for most of the increase in inventory investment this year. This reflects a bumper grain crop in conjunction with an over-supply on international markets, and large net imports of gold. The inventory-to-sales ratio is only slightly above its average over the past three years.

Current Account Deficit Remains Large

The current account deficit widened slightly to $8.8 billion in the third quarter from $7.9 billion in the second quarter but continues to show an improvement from its revised record first quarter level of $10.9 billion. Sharp declines in export prices of crude petroleum, wheat and natural gas, slower growth in demand from Canada's major trading partners and strong Canadian demand for imports explain the deterioration of the current account balance in 1986. The monthly merchandise trade pattern has been quite pronounced. While the nominal merchandise trade surplus declined to $7.7 billion in the third quarter (Chart 5), the trade balance has registered a substantial turnaround since July. The merchandise trade balance improved from a deficit of $0.3 billion in that month (the first since 1976) to surpluses of $16 billion and $10 billion in September and October respectively.

Output Performance of Goods-Producing Sector Dominated by Energy

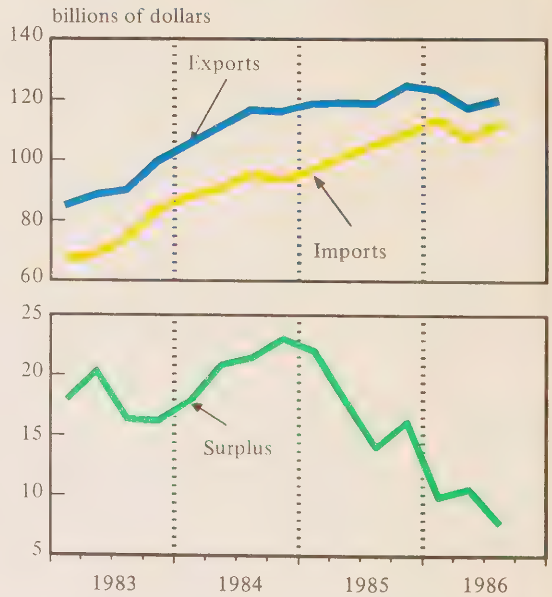
Output in the service sector has grown strongly in 1986 whereas goods sector output declined in the second and third quarters, largely due to declines in energy-related output. Excluding energy-related industries, goods sector output has been largely unchanged over the first three quarters of the year while service output, accounting for about 60% of GDP, is up 5.3%.

Unemployment Rate Remains at Lowest Level Since March 1982

Despite considerable fluctuations in employment and labour force growth during the year, movements in the unemployment rate have been subdued. The unemployment rate declined from 10.0% in December 1985 to 9.4% in October and November of this year.

Chart 5

Merchandise Trade of Canada



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Department of Finance Canada   Ministère des Finances Canada

The Economy in Brief

A Quarterly Publication of the Department of Finance

March 1987

Highlights of Recent Developments

- *Real growth slowed to 0.2% in the fourth quarter of 1986 from 0.8% in the third quarter. Healthy growth in both domestic and export demand was offset by a large reduction in inventory investment.*
- *Despite an inventory-induced slowdown in growth in the second half of the year, real economic activity expanded by 3.1% in 1986.*
- *The sharp decline in international energy and wheat prices in 1986, coupled with strong domestic demand for imports, resulted in a sharp rise in the current account deficit from $0.6 billion in 1985 to $8.8 billion in 1986.*
- *Employment rose by 2.9% last year, the largest annual rate of increase since 1980. There were 205,000 jobs created over the course of 1986.*
- *Since the beginning of 1987, the dollar has appreciated against the U.S. currency, interest rates have dropped sharply, inflation has eased and employment growth has continued strongly.*

Summary

The Canadian economy grew at a rate of 3.1% in 1986, despite a significant slowdown in the second half of the year due to large inventory adjustments. This was the fourth year of recovery with growth above 3%, and placed Canada as the fastest growing economy among the major OECD countries in 1986.

The pattern of economic growth throughout 1986 was influenced principally by the impacts of large declines in oil and grain prices and by swings in total inventory investment. The strong pace of economic activity during the first half of 1986 was due mainly to a rapid buildup of inventories which more than offset the decline in net exports and weak final domestic demand (due to energy-related investment declines). In the second half, inventory investment fell, with a $1.1 billion decumulation in the fourth quarter, while both final domestic demand and net exports picked up strongly.

Real growth in the fourth quarter of 1986 averaged 0.2% following a 0.8% advance in the third quarter. Weakness in the second half of

Chart 1

Employment Since January 1986

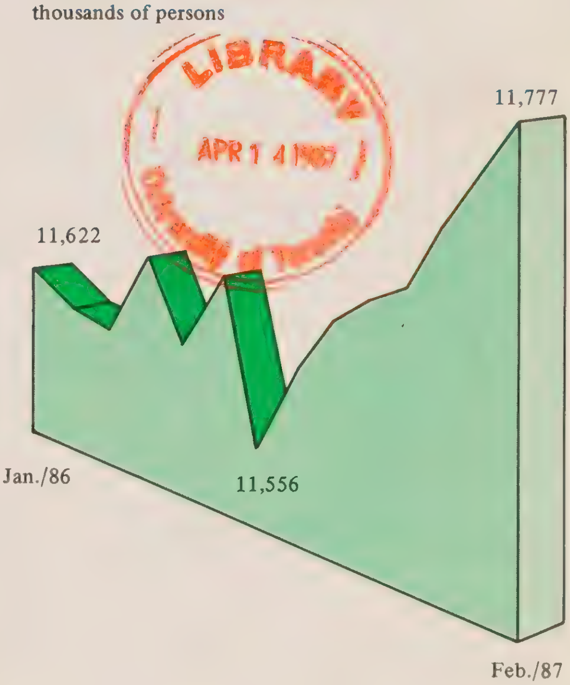

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Chart 2

Components of Demand

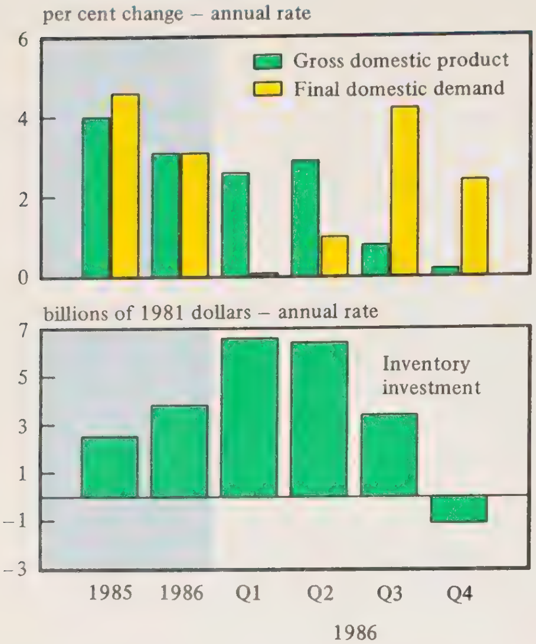
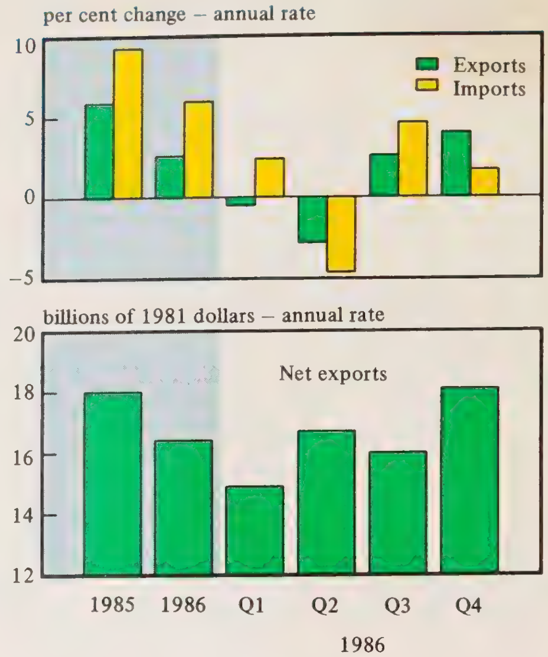


Chart 3

The Real Trade Balance



Main Economic Indicators

				1985		1986			
		1985	1986	Q3	Q4	Q1	Q2	Q3	Q4
Real output and demand (1981 dollars)									
GDP	(%,a.r.)	4.0	3.1	3.1	7.3	2.6	2.9	0.8	0.2
Final domestic demand	(%,a.r.)	4.6	3.1	7.5	5.3	0.1	1.0	4.2	2.4
Consumption	(%,a.r.)	5.0	4.0	7.4	4.5	0.7	4.8	6.6	0.9
Business capital formation	(%,a.r.)	6.6	3.6	17.1	7.6	0.2	−8.1	1.6	8.2
Residential construction	(%,a.r.)	12.6	13.2	35.5	34.5	−10.8	8.0	20.5	17.7
Non-residential construction	(%,a.r.)	3.7	−7.7	−6.2	−15.5	15.9	−30.5	−23.5	4.3
Machinery and equipment	(%,a.r.)	4.5	5.4	27.2	8.9	−1.8	0.6	8.2	2.6
Inventory investment	($b,a.r.)	2.5	3.8	4.0	1.3	6.6	6.4	3.4	−1.1
Business non-farm	($b,a.r.)	2.0	2.2	3.8	1.4	4.4	3.8	1.3	−0.7
Trade balance	($b,a.r.)	18.0	16.4	13.5	17.4	14.9	16.7	16.0	18.1
Current account balance	($b, current, a.r.)	−0.6	−8.8	−4.5	−3.6	−10.8	−7.6	−7.8	−9.1
Costs and prices									
GDP price inflation	(%,Y/Y)	3.4	2.8	4.1	3.9	3.3	2.6	2.4	3.0
Consumer Price Index	(%,Y/Y)	4.0	4.1	4.0	4.2	4.2	3.9	4.2	4.3
CPI – energy	(%,Y/Y)	5.6	−7.1	4.7	5.3	2.4	−8.2	−9.7	−13.0
Excluding food and energy	(%,Y/Y)	4.0	5.3	4.2	4.4	4.7	5.4	5.4	5.6
Change in unit labour costs	(%,Y/Y)	3.1	2.5	3.7	2.7	2.7	2.1	1.9	3.3
Labour Market									
Unemployment rate	(%)	10.5	9.6	10.2	10.1	9.7	9.6	9.7	9.4
Change in employment	(%)	2.8	2.9	0.6	1.0	1.2	0.2	−0.3	0.6
Financial Developments									
Exchange rate (closing)	(U.S. cents)	71.52	72.44	72.77	71.52	71.64	72.34	72.07	72.44
Prime interest rate	(%)	10.58	10.52	10.33	10.00	12.00	10.58	9.75	9.75
1-Year mortgage rate	(%)	10.31	10.15	10.00	9.83	11.17	9.92	9.75	9.75

last year was due largely to a significant reduction in inventory investment from the unsustainable pace in the first half of the year. Consumer demand remained relatively strong and the merchandise trade balance improved significantly. The current low levels of interest rates, the healthy financial positions of consumers and businesses, stable inflation and Canada's improved competitive position all suggest that the economy is well poised for continued growth in 1987.

For the year 1986 as a whole, employment was up 2.9%, the strongest annual rate of increase since 1980. Employment growth strengthened steadily after July in line with the rebound in growth in final domestic demand and export sales. The level of employment rose by 221,000 between July and February (Chart 1).

Canada's current account balance in 1986 was significantly affected by sharp declines in international prices for oil and gas and grains, and continuing weakness in other primary product prices. For the year, the current account deficit increased to $8.8 billion from $0.6 billion in 1985, with Canada registering a 3.4% decline in its terms of trade. In volume terms, however, the second half of 1986 witnessed a sharp pick-up in real merchandise exports after declines over the first six months of the year, and the real merchandise trade surplus improved significantly in the fourth quarter of 1986.

Final Domestic Demand Shows Healthy Growth

After increasing strongly in the third quarter, growth in final domestic demand slowed in the fourth quarter but still maintained a healthy pace (Chart 2). Growth in consumer demand was down noticeably after two quarters of large increases, mainly due to a decline in auto-related expenditures. Business capital investment rose briskly after sluggish growth over the previous three quarters, led by a rebound in non-residential construction that was concentrated in higher exploration and development in the petroleum sector. Residential investment again rose sharply in the fourth quarter. Housing starts averaged 212,000 units in the second half of 1986, the first time housing starts have remained above 200,000 for six consecutive months since 1978, and have remained substantially above 200,000 units through February of this year.

More Balanced Inventory Situation at Year End

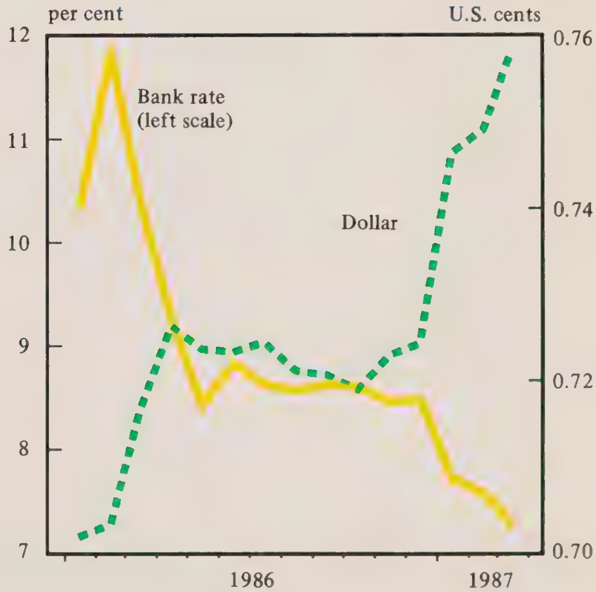
Inventories were very volatile in 1986. After a large increase in the first quarter of the year, non-farm inventory investment decreased in the second and third quarters, culminating in a decumulation in the last quarter of the year. At year end, the ratio of non-farm inventories to sales had returned to its 1983-1985 average level.

Merchandise Trade Surplus Up Sharply

The merchandise trade balance improved substantially in the fourth quarter as exports increased strongly for the second consecutive quarter while growth in imports slowed considerably (Chart 3). Shipments of grain and motor vehicles were the main contributors to the export growth. The improvement in the merchandise trade balance was actually less marked in nominal than real terms in the fourth quarter as Canada's terms of trade worsened in the face of continuing weakness in commodity prices. Despite the improved merchandise trade situation, the current account balance deteriorated in the fourth quarter, in part owing to the reappearance of a deficit on travel transactions following the end of Expo 86.

Chart 4

Movements in the Bank Rate and the Canadian Dollar



Last data plotted March 12.

The Economy in Brief

Investment Intentions Up for 1987

The recently released Private and Public Investment Intentions (PPI) survey by Statistics Canada suggests that the value of business non-residential investment spending is expected to increase by 4.3% in 1987, or about 1.5% in real terms. This follows a real decline of 0.8% in 1986. Non-energy investment is expected to rise by 6.2% (or about 3.5% in real terms), but will be partially offset by anticipated further declines in energy investment. Investment growth is expected to be more evenly spread among industries than in 1986.

The Dollar Strengthens and Interest Rates Drop

The Canadian dollar has climbed steadily since December. This strength is attributed by many to the interest rate gap between Canada and the U.S., an expectation of a firming of commodity prices, particularly oil, and the continued decline in the federal government deficit. The strength of the Canadian dollar has permitted considerable declines in Canadian interest rates (Chart 4). The Bank Rate has fallen by 1.2 percentage points since the beginning of the year and is now at its lowest level since 1974. The prime rate, at 8.75%, and mortgage interest rates are at their lowest levels since 1978.

Foreign Purchases of Canadian Bonds at Record Levels

Net foreign purchases of Canadian bonds doubled in 1986. Purchases by Japanese investors in particular soared, accounting for 40% of total purchases over the year, and purchases by other overseas countries increased strongly, while net purchases by U.S. investors decreased slightly. Factors accounting for this large capital inflow include attractive yields on Canadian securities, the relative strength of the Canadian economy compared to the other major industrial countries and large current account surpluses in Japan and elsewhere that are being reinvested internationally.

Inflation Stable in the Quarter, Drops in January

Consumer prices rose 4.3% on average in the fourth quarter on a year-over-year basis. For 1986 as a whole, the CPI was up 4.1%, the third year of price level increases around 4%. Although energy price declines put downward pressure on the CPI through the year, increases in food prices, indirect taxes, and housing costs and the decline in the value of the Canadian dollar against overseas currencies put upward pressure on the CPI (Chart 5). In January of this year, the year-over-year increase in the CPI dropped to 3.9% from 4.2% in December.

Strong Employment Growth in 1986

Employment increased by 2.9% in 1986. The labour force increased 1.8%, with increased participation, especially from adult women as the main factor underlying this growth. The unemployment rate averaged 9.6% in 1986, down from 10.5% in 1985. While employment growth was strong in 1986, it was not evenly spread through the year. Employment declined slightly between January and July, in response to weak final domestic demand growth, but rebounded in the second half of the year in line with strengthening domestic demand. This strong pace of employment growth continued in January and February, but a pick-up in labour force growth left the unemployment rate at 9.6% in February.

Chart 5

CPI Inflation in Canada

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A Quarterly Publication of the Department of Finance

June 1987

Highlights of the First Quarter

- *Real growth picked up very strongly to 6.3% (annual rate) in the first quarter of the year. Final domestic demand was also very robust, growing at 6.1%.*
- *Residential investment continued to be the strongest component of final domestic demand as housing starts rose to levels not seen since 1978.*
- *Business non-residential investment spending surged, led by very strong growth in machinery and equipment and a turnaround in non-residential construction.*
- *The trade balance improved in the first quarter, contributing noticeably to overall growth. Exports of goods and the terms of trade both increased.*
- *Employment growth increased to a 4.2% annual pace in the first six months of 1987. Moreover, the employment expansion has become more broadly based than in 1986, with most industries and provinces showing significant employment gains. The unemployment rate dropped to 8.9% in June, its lowest level since February 1982.*

Summary

The Canadian economy grew at an annual rate of 6.3% in the first quarter of the year (Chart 1). This was the strongest rate of increase since the fourth quarter of 1985 and was much higher than most forecasters had expected. It confirms the underlying strength in the economy previously indicated by the sharp rise in employment since July 1986, and contrasts sharply with the sluggish pace of output growth in the second half of 1986.

Final domestic demand rose substantially during the first quarter of 1987 reflecting an upturn in consumer expenditure on goods and a very strong increase in business and residential investment. Final domestic demand growth has not been so broadly based since mid-1985.

Looking ahead (second quarter GDP estimates to be released by September), current surveys indicate business managers and consumers are confident about near-term economic prospects. Surveys of investment intentions indicate that investment spending should continue to be robust. The housing market remained buoyant in the second quarter with housing starts averaging 244,000 units, the highest quarterly level of starts in nine years. Moreover, employment growth accelerated in the second quarter.

In nominal terms, the trade balance with both the United States and overseas countries strengthened during the first quarter of 1987, aided by an improvement in the terms of trade. In real terms the merchandise trade balance also strengthened, and accounted for close to one percentage point of GDP growth. On average in April and May, the trade balance improved further.

Chart 1

Change in Real GDP and Employment Since the Beginning of 1986

Canada

The Economy in Brief

Chart 2

GDP and Final Domestic Demand

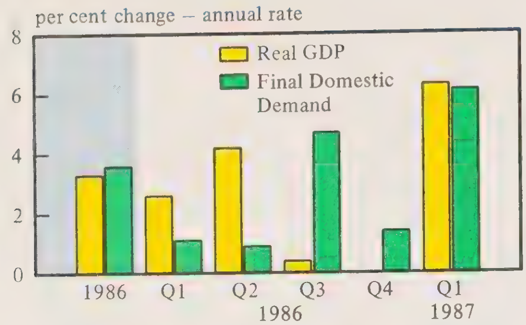


Chart 3

Consumption and Investment

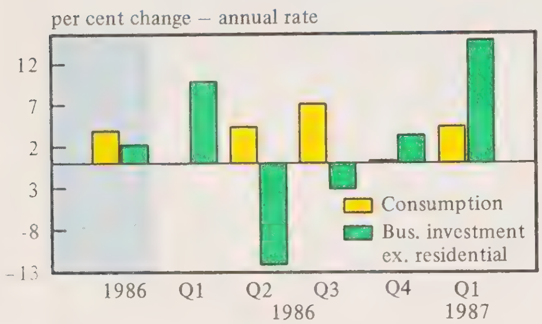


Chart 4

Inventory Change

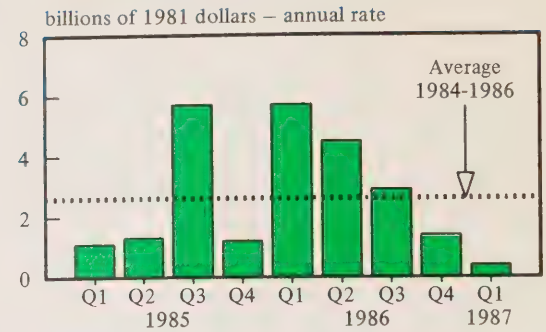
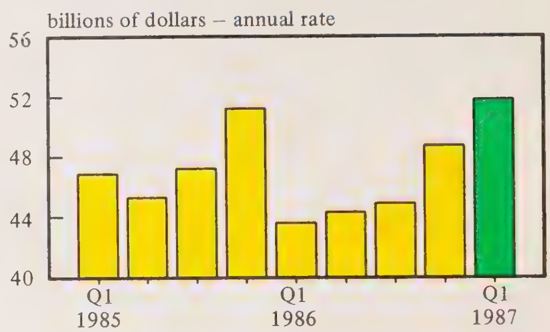


Chart 5

Corporation Profits Before Taxes



Main Economic Indicators

			1985	1986				1987	
		1986	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Real output and demand (1981 dollars)									
GDP	(%,a.r.)	3.3	6.8	2.6	4.2	0.4	0.0	6.3	–
Final domestic demand	(%,a.r.)	3.6	6.2	1.1	0.9	4.7	1.4	6.1	–
Consumption	(%,a.r.)	3.9	4.6	–0.1	4.4	7.1	0.3	4.4	–
Business capital formation	(%,a.r.)	6.2	10.8	7.3	–6.8	2.3	6.3	16.8	–
Residential construction	(%,a.r.)	14.9	35.0	2.3	5.0	13.6	12.3	20.7	–
Non-residential construction	(%,a.r.)	–8.2	–11.6	10.3	–31.4	–22.0	–1.2	4.4	–
Machinery and equipment	(%,a.r.)	11.5	13.0	9.5	6.9	13.2	6.5	22.1	–
Inventory investment	($b,a.r.)	3.6	1.2	5.7	4.5	2.9	1.4	0.4	–
Business non-farm	($b,a.r.)	1.7	1.2	3.6	2.1	0.9	0.1	1.5	–
Trade balance	($b,a.r.)	16.6	17.4	14.9	18.9	16.2	16.4	17.4	–
Current account balance	($b, current, a.r.)	–9.3	–4.3	–10.6	–6.3	–8.4	–11.7	–8.9	–
Incomes and savings									
Personal disposable income	(%,a.r.)	1.1	2.7	4.0	0.4	–4.1	2.7	0.7	–
Profits before taxes	(%,a.r.)	–4.8	38.4	–47.8	7.1	5.9	38.0	28.2	–
Costs and prices									
GDP price inflation	(%,Y/Y)	3.0	3.8	3.3	2.7	2.6	3.3	4.1	–
Consumer price index	(%,Y/Y)	4.1	4.2	4.2	3.9	4.2	4.3	4.0	4.6
CPI - energy	(%,Y/Y)	–7.1	5.3	2.4	–8.2	–9.7	–13.0	–9.8	4.1
Excluding food and energy	(%,Y/Y)	5.3	4.4	4.7	5.4	5.4	5.6	5.1	4.4
Change in unit labour costs	(%,Y/Y)	3.0	3.4	3.3	2.5	2.3	3.7	2.9	–
Labour market									
Unemployment rate	(%)	9.6	10.1	9.7	9.6	9.7	9.4	9.6	9.1
Change in employment	(%)	2.9	1.0	1.2	0.2	–0.3	0.6	0.8	1.1
Financial developments									
Exchange rate (closing)	(U.S. cents)	72.44	71.52	71.64	72.34	72.07	72.44	76.60	75.08
Prime interest rate (end of period)	(%)	9.75	10.00	12.00	10.25	9.75	9.75	8.75	9.50

Source: Statistics Canada and the Bank of Canada.

Inventory investment in constant dollars fell by $1 billion in the first quarter of 1987 to $0.4 billion, following even larger declines in the previous three quarters. Farm inventories decreased sharply during the quarter due to strong grain exports, while business non-farm inventory investment picked up moderately. The business non-farm inventory-to-sales ratio remains below trend, and some inventory buildup, and hence a boost to output growth, is to be expected.

Employment growth in Canada has shown a marked increase since July 1986. In the first half of 1987, employment continued to increase strongly and 246,000 jobs were created, a 4.2% annual pace of job creation. The gains have been more broadly based this year, with strong employment increases in most sectors of the economy and provinces. The unemployment rate fell to 8.9% in June from 9.7% in January of 1987, although the extent of the decline was tempered by strong labour force growth.

Final Domestic Demand Strengthens

Over the past three quarters, final domestic demand has increased at an average annual rate of 4.0% and, in the second half of 1986, had outpaced the growth of real GDP (Chart 2). Both real GDP growth and final domestic demand growth accelerated sharply in the first quarter of this year. Consumer expenditure increased strongly in the first quarter (Chart 3) as spending on goods rebounded, led by a bounce-back in auto spending. Spending on consumer services continued to grow at a strong pace. Consumer confidence, as indicated by the latest Conference Board of Canada survey, remains close to its historical high. The savings rate dropped to 9.5%, its lowest level since the mid-1970s.

Real non-residential investment increased by 14.7% in the first quarter reflecting a turnaround in non-residential construction and a sharp 22% increase in investment in machinery and equipment. The increase in machinery and equipment investment in the first quarter was the largest since the third quarter of 1985. Recent surveys of business attitudes indicate that business managers have become more confident. The recently released Department of Regional Industrial Expansion April survey of investment intentions of major corporations shows stronger investment intentions for 1987 than reported in last October's survey.

Business Inventories Trimmed

Inventory investment was very volatile in 1986, importantly influencing the pattern of real GDP growth through the year (Chart 4). In the first quarter of 1987, real inventory investment decreased a further $1 billion following a $1.5 billion decrease in the previous quarter. The downswing in inventory investment continued to reduce real GDP growth, but by less than was the case in the second half of 1986. Farm inventories were run down in the first quarter to meet export demand, whereas non-farm business inventories were up. The change in non-farm business inventories in the first quarter remained below its average in the past three years, and the stock-to-sales ratio remains below trend, suggesting that further increases in production are required to bring inventories back to desired levels.

Profits Up Sharply

Pre-tax profits of Canadian corporations rose at an annual rate of 28% in the first quarter of 1987, with mineral fuels and petroleum refining industries accounting for a large part of the overall gain. Other substantial gains occurred in the wood, paper and allied, and chemical products industries, reflecting higher prices and strong demand. Pre-tax profits have shown two consecutive large quarterly increases and are now back to their aggregate levels at the end of 1985 prior to the dramatic decline in world oil and grain prices (Chart 5).

Housing Market Booms

Residential investment in real terms increased by almost 21% in the first quarter, the third consecutive quarter of double-digit growth. In March, housing starts rose to levels not seen since 1978 and the strength continued in the second quarter with June recording 243,000 starts at an annual rate. June marked the twelfth consecutive month of starts at or above 200,000 units. The house resale market has also been buoyant, and prices of new houses have increased sharply, especially in the Toronto metropolitan area.

Pick-Up in Year-Over-Year Inflation Rate

The year-over-year increase in the all-items CPI rose from 3.9% in January to 4.8% in June. Increases in energy prices, following the sharp declines in early 1986, and increases in food

prices in May and June put upward pressure on inflation. As well, the impact of higher indirect taxes in 1986 also exerted upward pressure on year-over-year measures of inflation. Excluding food and energy, the year-over-year increase in the CPI has actually declined from 5.4% in January to 4.3% in June. Cost fundamentals remain favourable. Economy-wide wage moderation and a resumption of solid productivity growth (3.0% at annual rates in the first quarter) have exerted downward pressure on unit labour costs. These two factors coupled with the appreciation of the Canadian dollar on a trade-weighted basis since the beginning of the year, should act to dampen the rate of inflation in the coming months.

Canadian Dollar Back Above U.S. $0.75

After climbing sharply during the first quarter in response to heavy inflows of portfolio capital (from U.S. $0.724 at the end of December to a high of U.S. $0.766 in March), the value of the Canadian dollar subsequently eased towards U.S. $0.74. More recently, the Canadian dollar has strengthened again, rising above U.S. $0.75. Since the beginning of the year, U.S. interest rates have increased. Canadian interest rates decreased during the first quarter and the differential between Canadian and U.S. interest rates dropped to 0.5 percentage points. Since March, Canadian interest rates have increased by over 1 percentage point to near 1986 year-end levels, and the differential has widened to 1.75 percentage points by mid-July.

Employment Growth More Broadly Based

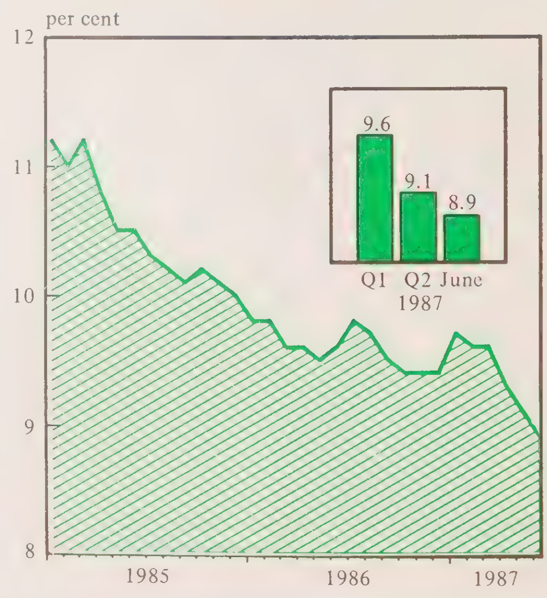
During the first half of the year, employment has increased at a buoyant 4.2% average annual rate of growth – an increase of 246,000 jobs. Growth has been broadly based with most sectors and provinces sharing in the increase. Full-time employment is growing strongly, indicating increased confidence of business managers in economic prospects. As a result of the strong employment growth, the unemployment rate fell from 9.7% in January to 8.9% in June. This is its lowest level since February 1982 (Chart 6).

Historical Revisions – Previous Real GDP Growth Estimates Revised Up

Statistics Canada has revised the Canadian Income and Expenditure Accounts data back to 1982. Overall, real GDP growth has been revised upwards significantly. The average annual rate of growth since the end of the 1981-82 recession is now 4.7% compared with 4.3% before the revisions. Real GDP growth in 1986 has been revised up to 3.3% from the initial estimate of 3.1%. As a result of these revisions, the level of real output in the Canadian economy at the end of 1986 was 1.3% higher than previously estimated. The level of pre-tax profits and labour income were also revised upwards by $1.2 billion and $4.1 billion respectively.

Chart 6

The Unemployment Rate



This publication summarizes the *Quarterly Economic Review* available from the Canadian Government Publishing Centre, Supply and Services Canada, Ottawa, K1A 0S9 (819-997-2560) at an annual subscription rate of $20.00. For inquiries on information in this publication, contact M. Kennedy (613-996-0336). Cet imprimé est également offert en français.

The Economy in Brief

A Quarterly Publication of the Department of Finance

September 1987

Highlights of the First Half

- *Real economic growth surged ahead at a 6.1% pace in both the first and second quarters of 1987. Buoyant consumption, housing and investment spending propelled the economy's growth, with final domestic demand increasing by 6.8% in the second quarter.*
- *Among the Group of Seven (G-7) countries, Canada again showed the strongest growth (4.5%) in the first half of 1987, after growing more rapidly than the other major industrialized countries in 1986.*
- *To date in 1987, 263,000 jobs have been created, an annual rate of increase of 3.4%, with all of the increase being full-time jobs. The unemployment rate in August dipped to 8.8%, down from 9.4% in December 1986.*
- *Business non-residential investment intentions now suggest that spending will increase 11.7% in 1987 or about 8% in real terms. This represents a major strengthening from the 4.3% increase previously planned and will mark a sharp pick-up from last year's investment performance.*
- *Consumer price inflation, on a year-over-year basis, rose during the first half of the year and reached 4.7% in July as a result of a turnaround in energy prices and increases in food prices. Excluding food and energy, however, CPI increases slowed. Unit labour cost increases remained moderate.*

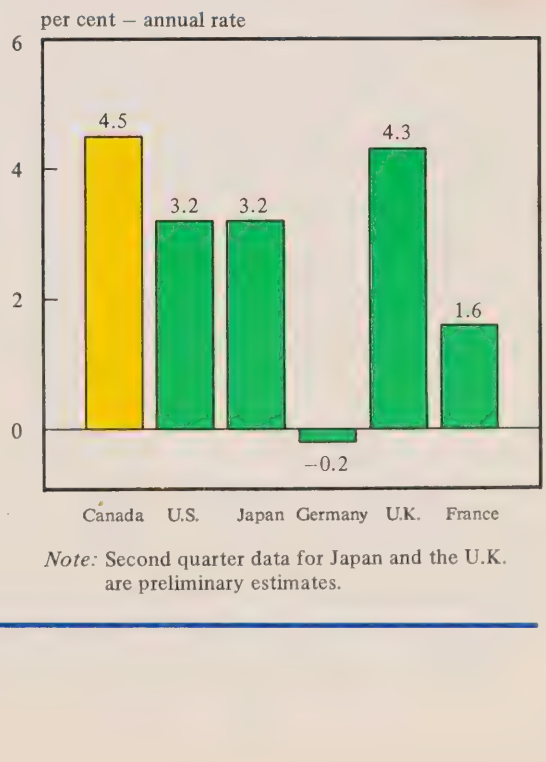
Summary

Real growth of the Canadian economy continued to be very strong and broadly based in the second quarter. Real GDP increased at an annual rate of 6.1%, the same as in the preceding quarter. These were the strongest back-to-back quarters of real output growth since the first half of 1984. The Canadian economy was the fastest growing among the major OECD economies in the first half of 1987, after leading G-7 growth in 1986 (Chart 1). The healthy growth in the economy was reflected in the rapid increases in full-time employment since the beginning of the year.

Business non-residential investment increased strongly in the first two quarters of this year. The current buoyancy in this investment is encouraging. According to the revised Private and Public Investment (PPI) Survey, business managers plan to increase non-residential investment by 11.7% in 1987, up sharply from the 4.3% expected in the preliminary survey

Chart 1

Real GNP/GDP Growth in Major OECD Countries First Half of 1987



Note: Second quarter data for Japan and the U.K. are preliminary estimates.

The Economy in Brief

Chart 2

Change in Real GDP and Final Domestic Demand

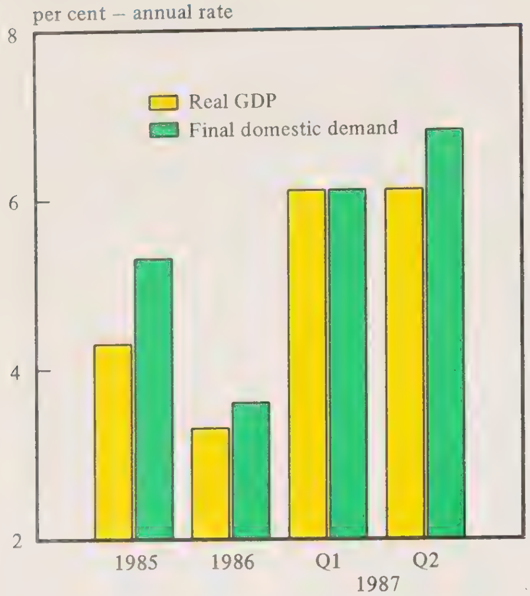
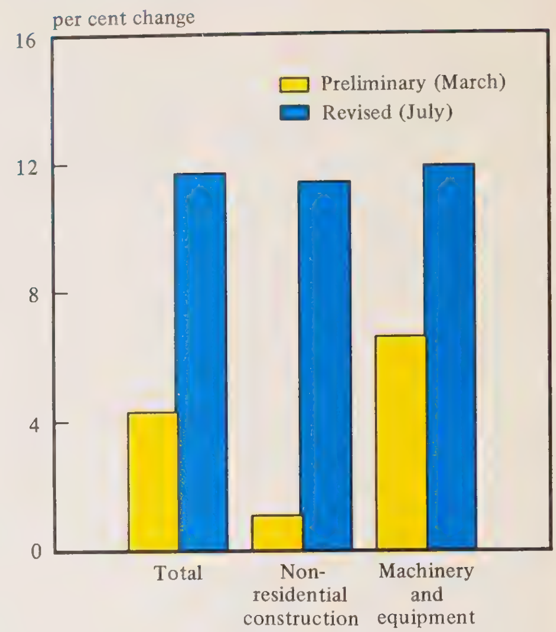


Chart 3

PPI Survey of Business Investment Intentions for 1987



Main Economic Indicators

				1986				1987	
		1985	1986	Q1	Q2	Q3	Q4	Q1	Q2
Real output and demand (1981 dollars)									
GDP	(% a.r.)	4.3	3.3	2.6	4.2	0.4	0.0	6.1	6.1
Final domestic demand	(% a.r.)	5.3	3.6	1.1	0.9	4.7	1.4	6.1	6.8
Consumption	(% a.r.)	5.2	3.9	-0.1	4.4	7.1	0.3	3.9	7.1
Residential construction	(% a.r.)	12.2	14.9	2.3	5.0	13.6	12.3	20.9	20.3
Business fixed investment	(% a.r.)	6.1	2.2	9.8	-12.1	-3.1	3.3	13.2	12.3
Non-residential construction	(% a.r.)	5.6	-8.2	10.3	-31.4	-22.0	-1.2	10.9	9.8
Machinery and equipment	(% a.r.)	6.5	11.5	9.5	6.9	13.2	6.5	14.8	14.0
Business inventory investment	($b a.r.)	2.4	3.6	5.6	4.5	3.1	1.3	0.1	0.6
Non-farm	($b a.r.)	1.7	1.7	3.6	2.1	0.9	0.1	1.8	1.7
Trade balance	($b a.r.)	18.4	16.6	14.9	18.9	16.2	16.4	17.7	16.7
Current account balance	($b current, a.r.)	-1.2	-9.3	-10.6	-6.3	-8.4	-11.7	-7.3	-8.0
Incomes and savings									
Real personal disposable income	(% a.r.)	4.2	1.1	4.0	0.4	-4.1	2.7	0.9	2.9
Profits before taxes	(% a.r.)	3.9	-4.8	-47.8	7.1	5.9	38.0	28.0	27.8
Costs and prices									
GDP price deflator	(% Y/Y)	3.2	3.0	3.3	2.7	2.6	3.3	4.2	4.6
Consumer price index	(% Y/Y)	4.0	4.1	4.2	3.9	4.2	4.3	4.0	4.6
CPI – energy	(% Y/Y)	5.6	-7.1	2.4	-8.2	-9.7	-13.0	-9.8	4.1
CPI – ex. food and energy	(% Y/Y)	4.0	5.3	4.7	5.4	5.4	5.6	5.1	4.4
Unit labour costs	(% Y/Y)	3.5	3.0	3.3	2.5	2.3	3.7	2.9	3.3
Labour market									
Unemployment rate	(%)	10.5	9.6	9.7	9.6	9.7	9.4	9.6	9.1
Employment	(% a.r.)	2.8	2.9	4.8	1.0	-1.1	2.6	3.2	4.6
Financial developments									
Exchange rate (closing)	(U.S. cents)	71.52	72.44	71.64	72.34	72.07	72.44	76.60	75.08
Prime interest rate (end of period)	(%)	10.00	9.75	12.00	10.25	9.75	9.75	8.75	9.50

Source: Statistics Canada and the Bank of Canada.

released earlier this year. This could yield a real increase in investment spending of about 8%, the strongest since 1981.

Final domestic demand continued to be the main contributor to economic growth in the second quarter, increasing sharply by 6.8% (Chart 2). This was the largest increase since the third quarter of 1985. Residential investment rose 20% for the second straight quarter and business non-residential investment continued to increase strongly, advancing by 12% in the quarter. Consumer expenditure, which contributed about 60% of the advance in final domestic demand, was boosted by marked increases in spending on durable goods, especially automobiles. The savings rate dropped to 8.8%, its lowest level since 1973. Business inventory investment increased slightly to $0.6 billion from $0.1 billion in the previous quarter. Business non-farm inventory investment was essentially unchanged but the decumulation in farm inventories was less than in the first quarter.

The trade balance decreased to $16.7 billion in real terms from $17.7 billion in the first quarter due to a decrease in the merchandise trade surplus. The terms of trade fell slightly after rising in the first quarter. The combined effects worsened the current account balance, with the deficit reaching $8.0 billion, compared to $7.3 billion in the first quarter.

Consumer Spending Up Sharply

Real consumer expenditure increased at an annual rate of 7.1% in the second quarter. Spending on automobile and related products, which registered a 31% increase, led consumer expenditure as car buyers responded to purchasing incentives. Expenditure on household furniture and appliances also continued to increase strongly, reflecting the high level of housing completions. Growth in spending on services slowed from the large increase in the first quarter.

The Savings Rate Drops

The personal savings rate fell to 8.8% in the second quarter from 9.7% in the previous quarter and an average of 11.5% in 1986. The decline in the savings rate continued a trend evident since early 1982. The personal savings rate is now less than half its 19.1% record level registered in the first quarter 1982. The recent declines reflect record levels of consumer confidence, as measured by Conference Board surveys, and the willingness of consumers to borrow to finance durable goods purchases.

Rebound in Profits Continues

Corporate profits before taxes rose by 28% in both the first and second quarters. Profit levels in the second quarter were 7.5% above their level at the end of 1985, before the marked decline in world oil prices. The increase in profits was widespread across sectors with particular strength in the petroleum sector. Despite the recent run-up in profits, profit margins (before-tax profits divided by sales) remained below their average pre-recession levels.

Buoyant Investment Intentions

The strong rise in capacity utilization in recent quarters to levels significantly above pre-recession averages has improved the outlook for new investment spending. The marked improvement in profits over the last year, the buoyant stock market, and the steady improvement in corporate liquidity have all increased the ability of corporations to fund additional investment spending. The revised PPI survey confirmed this increasingly bullish investment outlook. Nominal business non-residential investment is expected to increase substantially by 11.7% in 1987 (Chart 3). Investment spending intentions increased in all sectors of the economy except agriculture and fishing, and forestry. All regions are expected to benefit from the more buoyant investment spending outlook, especially British Columbia. This is the first time since 1981 that capital investment has been projected to increase at such a strong rate.

Moderate Inventory Investment

Real business inventory investment increased slightly during the quarter to $0.6 billion. The change reflects a $1.1 billion decumulation in farm inventories, which was significantly less than in the first quarter, and a $1.7 billion accumulation of business non-farm inventories, about the same pace as in the first quarter.

The Economy in Brief

For the first time since the beginning of 1986, inventory investment contributed to growth. Business non-farm inventory investment remained below that required to maintain the stock-to-sales ratio near its short-term trend value, suggesting that inventory investment should also contribute to growth in the second half of the year.

Trade Surplus Slips

Both real exports and imports decreased during the quarter after three quarters of rapid growth. The real trade surplus decreased by $1 billion to $16.7 billion. The drop in exports was mainly due to lower exports of cars, while the decrease in imports was widespread. The terms of trade, after rising 3.3% (annual rates) in the first quarter, decreased by 1.7%. As a result, the current account deteriorated slightly to a deficit of $8 billion.

Employment Growth More Balanced

Employment rose by 0.4% in August (an increase of 42,000 jobs). Since the beginning of the year, employment has risen at an annual rate of 3.4%, an increase of 263,000 jobs. The strong employment growth has become more broadly based by sectors and by regions with strength particularly evident in the Atlantic region, Quebec and British Columbia. The unemployment rate decreased to 8.8% in August, its lowest level since February 1982.

CPI Inflation Up

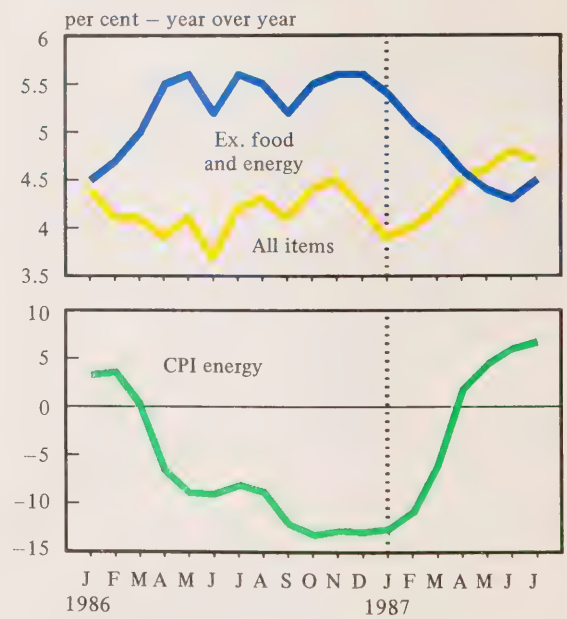
Consumer prices advanced by 4.7% on a year-over-year basis in July, up from the 3.9% increase in January but down slightly from June. The stronger increases in the CPI since January resulted from a turnaround in energy prices and, to a lesser extent, higher food prices (Chart 4). Indeed, excluding food and energy, the CPI rose 4.5% in July compared to 5.4% in January. Unit labour costs continued to be moderate, increasing by 3% on a year-over-year basis in the first half of the year, the same as in 1986.

Dollar Remains Stable

In the past few months, the Canadian dollar has remained fairly stable both against the U.S. dollar and on a trade-weighted basis. The Canadian dollar has been trading in a narrow range between U.S. $0.75 and $0.76. The differential between Canadian and U.S. 90-day commercial paper rates has widened since March as Canadian rates have risen to over 9% while comparable U.S. interest rates had decreased slightly until recently. The interest rate differential is currently over 2 percentage points.

Chart 4

Consumer Price Inflation



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Department of Finance Canada · Ministère des Finances Canada

e Economy in Brief

A Quarterly Publication of the Department of Finance

December 1987

Highlights of the Third Quarter

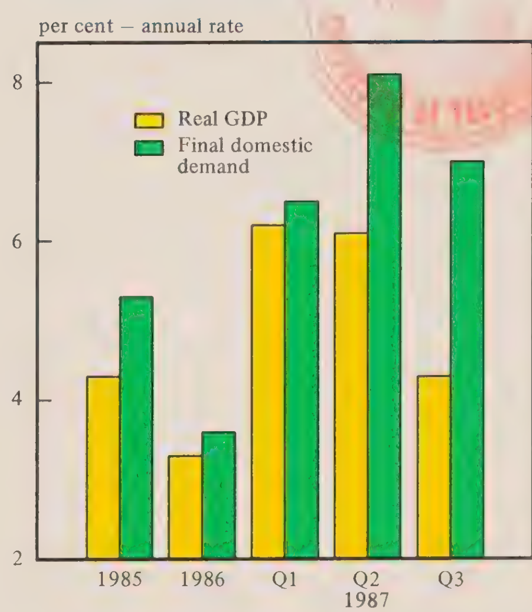
- *Real gross domestic product (GDP), buoyed by surging final domestic demand, rose by a strong 4.3% at an annual rate in the third quarter, following the very rapid pace of over 6% in the previous two quarters. Real output growth in Canada to date in 1987 is the strongest among the major industrial countries.*
- *The fastest growing component of final domestic demand was business investment which surged by 21.6% at an annual rate, led by purchases of machinery and equipment. Continued strong profit growth, buoyant business confidence and high levels of capacity utilization are the key factors underlying the strength in business investment.*
- *Stock markets throughout the world plunged on October 19. In Canada and the United States, it was the largest ever one-day decline. Governments moved quickly to provide liquidity to stabilize financial markets.*
- *Consumer price inflation slowed to 4.3% on a year-over-year basis in October, down from the yearly peak of 4.8% posted in June. Price increases in October were lower in Canada than the United States for the first time since December 1984.*
- *The unemployment rate dropped to 8.2% in November, its lowest level since November 1981. Since December 1982, 1,628,000 jobs have been created and 398,000 of these jobs were created in the first 11 months of 1987.*

Summary

The Canadian economy continued to grow strongly in the third quarter. Real GDP increased at an annual rate of 4.3%, following two quarters of growth above 6% (Chart 1). The strong growth in the economy resulted from robust final domestic demand which grew 7.0%. Net exports decreased substantially (by $3.6 billion) during the quarter due to a large increase in imports, especially of machinery and equipment, reflecting the strength in business investment. Rapid increases in employment continued in the third quarter. In the first 11 months of the year, employment rose by 398,000 jobs and all net job gains were full time.

Chart 1

Change in Real GDP and Final Domestic Demand



Business non-residential investment maintained its very buoyant pace of growth from the first half of the year, expanding at an annual rate of 21.6% in the third quarter alone. The brisk pick-up in non-residential investment in recent

Canada

The Economy in Brief

Chart 2

Change in Real Business Investment

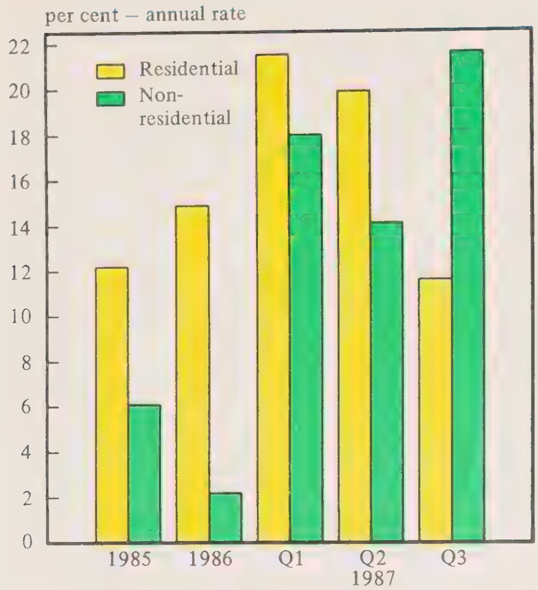


Chart 3

Employment Growth and the Unemployment Rate

Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1986			1987		
		1985	1986	Q2	Q3	Q4	Q1	Q2	Q3
Real gross domestic product		4.3	3.3	4.2	0.4	0.0	6.2	6.1	4.3
Final domestic demand		5.3	3.6	0.9	4.7	1.4	6.5	8.1	7.0
Consumption		5.2	3.9	4.4	7.1	0.3	3.4	7.9	5.5
Residential construction		12.2	14.9	5.0	13.6	12.3	21.5	19.9	11.6
Business fixed investment		6.1	2.2	-12.1	-3.1	3.3	18.0	14.1	21.6
Non-residential construction		5.6	-8.2	-31.4	-22.0	-1.2	10.8	9.5	11.7
Machinery and equipment		6.5	11.5	6.9	13.2	6.5	23.1	17.1	28.2
Business inventory investment	($b,a.r.)	2.4	3.6	4.5	3.1	1.3	1.0	-0.2	0.7
Non-farm	($b,a.r.)	1.7	1.7	2.1	0.9	0.1	1.1	-0.2	0.6
Trade balance	($b,a.r.)	18.4	16.6	18.9	16.2	16.4	17.0	16.9	13.3
Current account balance	($b, current, a.r.)	-1.2	-9.3	-6.3	-8.4	-11.7	-6.8	-7.0	-10.4
Incomes and savings									
Real personal disposable income		4.2	1.1	0.4	-4.1	2.7	2.3	2.9	0.8
Profits before taxes		3.9	-4.8	7.1	5.9	38.0	23.7	42.1	19.6
Costs and prices	(%,Y/Y)								
GDP price deflator		3.2	2.9	2.7	2.5	3.2	4.2	4.8	4.5
Consumer price index		4.0	4.1	3.9	4.2	4.3	4.0	4.6	4.6
CPI – energy		5.6	-7.1	-8.2	-9.7	-13.0	-9.8	4.1	8.1
CPI – ex. food and energy		4.0	5.3	5.4	5.4	5.6	5.1	4.4	4.4
Unit labour costs		3.5	3.0	2.5	2.3	3.7	3.0	3.2	2.5
Labour market									
Unemployment rate		10.5	9.6	9.6	9.7	9.4	9.6	9.1	8.8
Employment		2.8	2.9	1.0	-1.1	2.6	3.2	4.6	2.5
Financial developments									
Exchange rate – closing	(U.S. cents)	71.52	72.44	72.34	72.07	72.44	76.60	75.08	76.26
Prime interest rate (end of period)		10.00	9.75	10.25	9.75	9.75	8.75	9.50	10.00

Sources: Statistics Canada and the Bank of Canada.

quarters reflects the turnaround of non-residential construction investment and continued very strong growth in machinery and equipment expenditure. High rates of capacity utilization, the sound financial positions and strong cash flow positions of industrial corporations, continuing robust business confidence and higher international oil prices are the main factors behind the strong investment growth of recent quarters.

Consumer expenditure growth slowed somewhat in the third quarter due in part to a smaller increase in spending on new cars. Nevertheless, consumer spending growth in the third quarter was strong and remained substantially above the average for 1986. The savings rate dropped over one percentage point to 8.0%, reflecting continuing high consumer confidence. Residential investment continued to increase very strongly, following two quarters of average growth exceeding 20%. Housing starts reached an annual rate of 263,000 units, the highest quarterly level in over nine years. Real business inventory investment rose by close to $1.0 billion in the third quarter but the inventory-to-sales ratio remained well below its recent trend.

The recent sharp stock market downturn brought Canadian stock prices down to their mid-1986 levels, and price/earnings ratios have fallen from the unusually high levels reached earlier in the year. The precise effects on the economy are not yet clear but they are expected to be modest. The very healthy financial position of the corporate sector, the positive attitudes of consumers according to recent surveys and the actions by governments to inject liquidity into the international financial system will act to mitigate the impact of the stock market decline on the economy's growth prospects over the next year.

Buoyant Business Investment

Real business non-residential investment rose at a very rapid pace of 21.6% at an annual rate in the third quarter, following an increase of 16.0% on average in the first two quarters of the year (Chart 2). These were the three strongest consecutive quarters of growth in investment since 1981. The strength reflected both a turnaround in non-residential construction, after an 8.2% decline in 1986, and booming machinery and equipment investment. In the third quarter, real residential investment increased at roughly half the 20% pace of the first half. With housing starts at very high levels, the growth of housing starts understandably slowed and activity in the market for existing housing eased.

Sharp Rise in Corporate Profits

Corporate profits before taxes continued to increase at an extremely strong pace. Since the third quarter of 1986, corporate profits have risen by close to $14 billion, a 31% advance. Real returns on equity in the resource sector have recovered from the sharp drop in 1986 and, although there has been a slight deterioration in the non-resource sector, overall real returns on equity are comparable to their pre-recession levels. The liquidity positions of industrial corporations are at their highest levels since before the recession. With strong cash flow positions, corporations are able to finance their investment largely from internally generated funds.

Consumer Spending Remains Strong

The pace of consumer expenditure growth slowed somewhat in the third quarter but nevertheless maintained a strong annual rate of growth of 5.5%. The slowdown in growth was more pronounced for durable goods, especially purchases of new cars. The savings rate decreased further to 8.0%, and is now at its lowest level since mid-1972. The downward trend in the savings rate over the past several quarters reflects, in part, the continuing high degree of consumer confidence.

Trade Balance Down Sharply

Real net exports fell by $3.6 billion to $13.3 billion in the third quarter. Exports of goods rose by 3.1%, but imports increased 17.2%. The large increase in imports of goods was mainly due to much higher imports of machinery and equipment reflecting the substantial increases in business investment in recent quarters. Despite a strong increase in the terms of trade, the current account balance deteriorated by $3.4 billion to a deficit of $10.4 billion.

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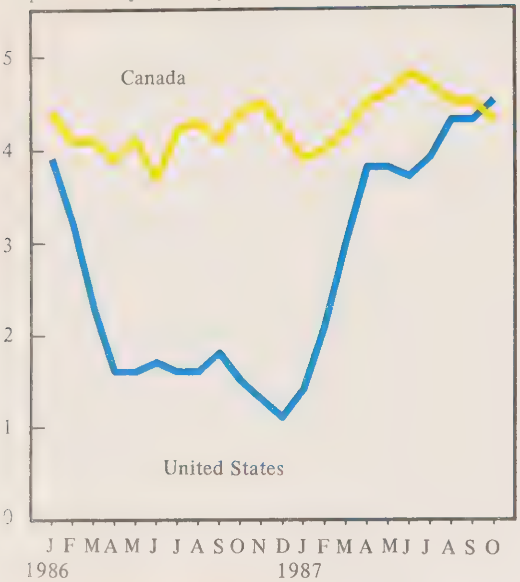
Chart 4

CPI Inflation in Canada and the U.S.

per cent – year over year



The Unemployment Rate Drops to 8.2%

Employment increased at a very brisk pace in the first 11 months of the year, reaching a level of 12,114,000, 3.8% above its level in November 1986. The rate of increase in jobs created to date in 1987 is more than in any full year since the 1981-1982 recession (Chart 3). Employment gains in 1987 are spread across all age groups, industries and provinces. All net job gains were full time, as part-time employment actually remained unchanged. Employment growth surpassed labour force growth in most months of 1987 and the unemployment rate dropped to 8.2% in November from 9.4% in December 1986. The rate of unemployment is now at its lowest level since November 1981.

Inflation Down to 4.3%

The consumer price index (CPI) advanced 4.3% (year over year) in October, down from 4.5% in September and August and the yearly peak of 4.8% in June. Recent declines in food prices and a decline in energy prices in October account for the slower inflation in October. Consumer prices are now increasing at a slower rate in Canada than in the United States for the first time since December 1984. The rebound in U.S. inflation reflects a sharper turnaround in energy prices and the depreciation of the U.S. dollar (Chart 4).

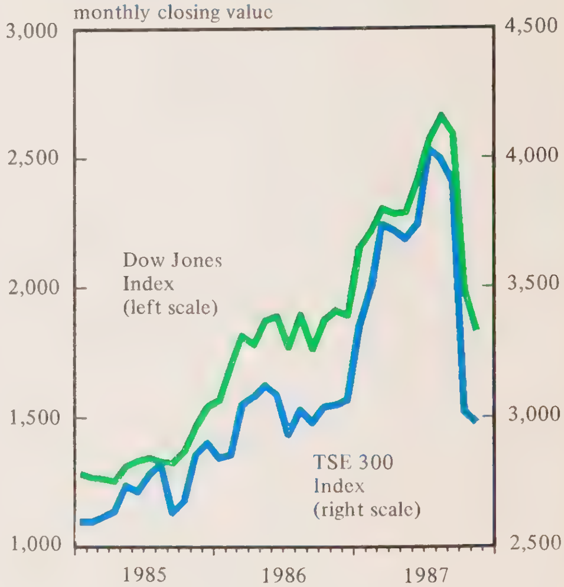
Stock Market Registers Record Drop

On October 19, North American stock markets experienced their largest ever one-day declines with the Dow Jones industrial index dropping 509 points (23%) and the TSE 300 index falling 401 points, or 11% (Chart 5). By the end of October, both the TSE 300 and Dow Jones were roughly 27% below their respective August peaks but still at levels above their 1986 average. Following the stock market crash, governments moved quickly to provide liquidity to stabilize financial markets.

Chart 5

TSE 300 and Dow Jones Industrials Indexes

monthly closing value



This publication summarizes the *Quarterly Economic Review* available from the Canadian Government Publishing Centre, Supply and Services Canada, Ottawa, K1A 0S9 (819-997-2560) at an annual subscription rate of $20.00. For inquiries on information in this publication, contact M. Kennedy (613-996-0336). Cet imprimé est également offert en français.

e Economy in Brief

A Quarterly Publication of the Department of Finance

March 1988

Highlights of the Fourth Quarter

- *Real gross domestic product (GDP) rose at an annual rate of 6.3% in the fourth quarter. Final domestic demand expanded by over 7%, outpacing real GDP for the sixth consecutive quarter. For 1987 as a whole, real output grew by 3.9% – substantially faster than was anticipated by most forecasters last year.*
- *Business non-residential investment spending in real terms was the most buoyant component of final domestic demand during the quarter, increasing by 30%. For the year, business investment rose 9.2% and is expected to grow even more rapidly in 1988, according to the Private and Public Investment Intentions (PPI) Survey just released.*
- *Consumer price inflation slowed throughout the second half of 1987. Inflation in the fourth quarter was lower in Canada than in the United States. Labour cost increases remained moderate in 1987.*
- *Employment surged 4.2%, or by 486,000 jobs, in 1987 and the unemployment rate declined 1.6 percentage points during the year to 8.1%. Another 95,000 jobs were created in January and February and the unemployment rate fell to 7.8%.*
- *The Canadian dollar has gained steadily against the U.S. dollar over the last year, reaching above U.S. $0.79 in February. On a trade-weighted basis, the dollar has also appreciated, although less so. By early March, the dollar had moved above U.S. $0.795.*

Summary

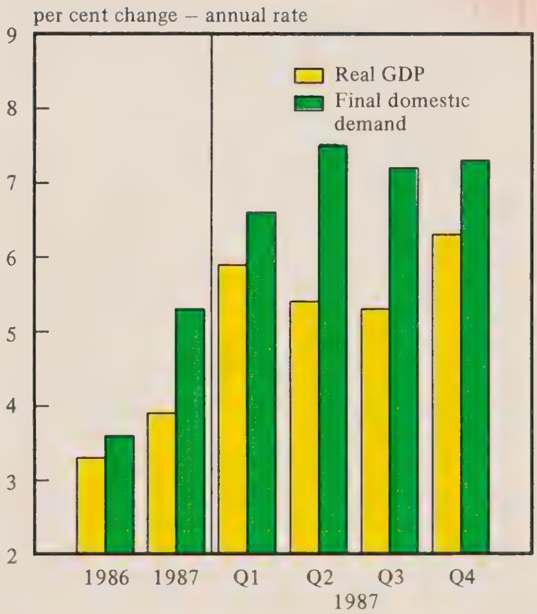
The Canadian economy performed very well in 1987. Growth in real output (GDP) was 6.3% at annual rates in the fourth quarter, bringing real GDP to a level 5.7% higher than a year earlier. On average for the year, real GDP expanded by 3.9%. The strength in 1987 was clearly reflected in labour markets as employment posted another sharp increase. The unemployment rate dropped from 9.7% at the beginning of 1987 to 8.1% by year-end.

The strength of the Canadian economy in 1987 was domestically based, and this trend continued in the fourth quarter (Chart 1). Neither consumption nor investment showed any evidence of a negative effect from the October stock market decline. Consumer spending was up sharply in the fourth quarter, and real business non-residential investment soared 30%.

Over the last four quarters, real business investment has risen 19%. According to the March 1988 PPI survey by Statistics Canada, business investment spending in real terms is expected to register a double-digit increase on average in 1988.

Chart 1

Real Gross Domestic Product and Final Domestic Demand



Canada

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Chart 2

Nominal Business Non-Residential Investment Intentions (March PPI)

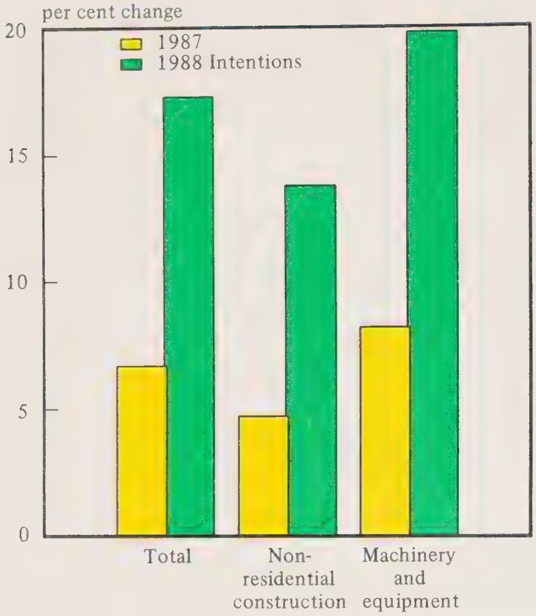
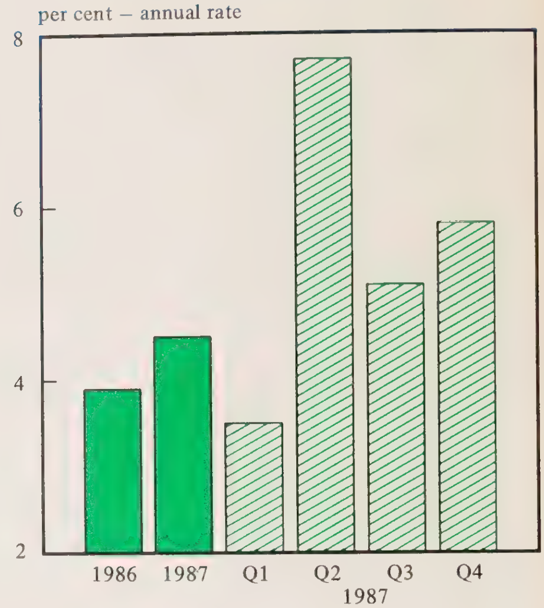


Chart 3

Change in Real Consumer Expenditure



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1986		1987			
		1986	1987	Q3	Q4	Q1	Q2	Q3	Q4
Real gross domestic product		3.3	3.9	0.4	0.0	5.9	5.4	5.3	6.3
Final domestic demand		3.6	5.3	4.7	1.4	6.6	7.5	7.2	7.3
Consumption		3.9	4.5	7.1	0.3	3.5	7.7	5.1	5.8
Residential construction		14.9	14.9	13.6	12.3	23.1	17.9	15.6	–4.5
Business fixed investment		2.2	9.2	–3.1	3.3	13.8	10.7	22.0	30.0
Non-residential construction		–8.2	1.6	–22.0	–1.2	10.5	9.4	12.8	30.4
Machinery and equipment		11.5	14.8	13.2	6.5	16.0	11.6	28.3	29.7
Business inventory investment	($b,a.r.)	3.6	1.9	3.1	1.3	1.1	0.2	1.1	5.0
Non-farm	($b,a.r.)	1.7	1.8	0.9	0.1	0.8	–0.0	1.0	5.5
Trade balance	($b,a.r.)	16.6	13.6	16.2	16.4	17.2	16.1	13.1	8.0
Current account balance	($b, current, a.r.)	–9.3	–9.6	–8.4	–11.7	–6.4	–7.8	–10.3	–14.0
Incomes									
Real personal disposable income		1.1	2.1	–4.1	2.7	3.3	3.0	1.5	8.1
Profits before taxes		–4.8	25.3	5.9	38.0	26.7	35.8	20.2	22.7
Costs and prices	(%,Y/Y)								
GDP price deflator		3.0	4.6	2.5	3.2	4.2	4.8	4.7	4.6
Consumer price index		4.1	4.4	4.2	4.3	4.0	4.6	4.6	4.2
CPI – energy		–7.1	2.6	–9.7	–13.0	–9.8	4.1	8.1	9.9
CPI – excluding food and energy		5.3	4.6	5.4	5.6	5.1	4.4	4.4	4.3
Unit labour costs		3.0	2.8	2.3	3.7	3.1	3.4	2.8	1.7
Labour market									
Unemployment rate		9.6	8.9	9.6	9.5	9.6	9.1	8.7	8.2
Employment		2.9	2.8	–0.3	2.2	3.3	4.5	2.9	4.9
Financial developments									
Exchange rate – closing	(U.S. cents)	72.44	76.96	72.07	72.44	76.60	75.08	76.26	76.96
Prime interest rate (end of period)		9.75	9.75	9.75	9.75	8.75	9.50	10.00	9.75

Sources: Statistics Canada and the Bank of Canada.

Residential investment decreased during the quarter as housing starts were down from the very strong pace of the previous two quarters. A significant part of the previous pent-up demand that has driven housing starts to record levels has now been satisfied in some parts of the country.

The continued strength of final domestic demand, particularly business investment spending, was reflected in a significant decrease in the merchandise trade surplus as growth in imports outstripped strongly increasing exports. While a strong terms of trade improvement dampened the impact on the current account, the current account deficit, nevertheless, increased to a record level in the fourth quarter.

Business non-farm inventory investment increased $4.5 billion in the final quarter of last year, but the inventory-to-sales ratio remained at its trend level. Farm inventory investment, on the other hand, fell $0.7 billion to $0.5 billion.

In 1987, consumer prices increased 4.4%, a rate of growth only slightly higher than in the previous three years. After rising sharply to 4.8% in June, consumer price increases moderated throughout the second half of last year to 4.1% in January of 1988. Moderate labour cost increases, slower energy and food price increases and the strength of the Canadian dollar all served to contain and lessen inflationary pressures.

Robust Business Investment

Business non-residential investment spending in real terms continued to rise at double-digit rates in the fourth quarter, with both non-residential construction and machinery and equipment investment climbing 30%. The current rapid growth in investment is being fueled by a sharp turnaround in corporate profits. Indeed, the share of profits in total GDP rose to its highest level since before the recession. Investment growth is expected to increase in 1988, according to the March PPI Survey by Statistics Canada (Chart 2). Nominal investment expenditures are expected to grow 17.3% in 1988, after a 6.7% increase in 1987, with a strong pick-up in growth in both the resource and non-resource sectors. The broadening of investment growth among sectors and regions is expected to continue in 1988. Indeed, for the first time since 1981, all major sectors and regions are expected to increase nominal investment spending in 1988.

Consumption Remains Strong

Real consumer expenditure growth continued to contribute very strongly to growth in final domestic demand during the fourth quarter, dispelling fears that the stock market decline would lead to a severe retrenchment of spending (Chart 3). Durable goods spending growth slowed somewhat from an over 10% increase in the previous quarter, but there was a strong pick-up in non-durable goods spending. Nevertheless, growth of personal disposable income exceeded consumer expenditure growth for the first time in four quarters, leading to a rise in the personal savings rate to 8.9% in the fourth quarter from 8.5% in the previous quarter.

Deterioration of the Current Account

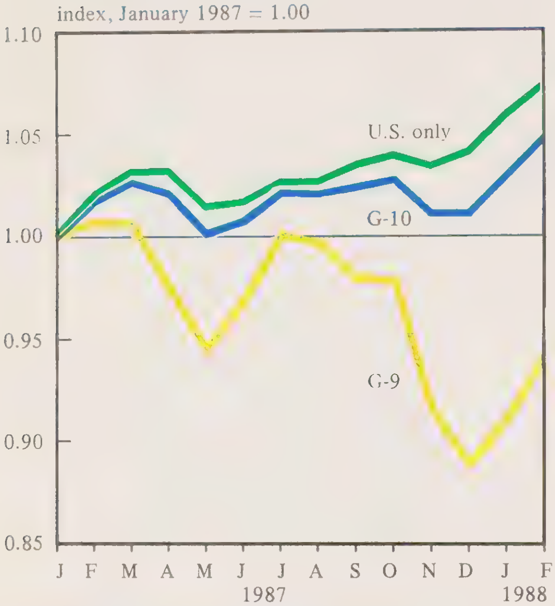
The substantial increase in final domestic demand in 1987, particularly the boom in business investment spending, resulted in a further deterioration of the current account balance. The merchandise trade surplus in real terms decreased $1.5 billion to $17.2 billion as a result of very strong growth of imports of finished products, especially motor vehicles, and machinery and equipment. However, Canada's terms of trade improved by 2% during the year, the first yearly increase since 1982. Even though the rise in the terms of trade dampened the effect of the lower trade volume, the current account deficit still averaged $9.6 billion, slightly larger than in 1986. While the trade balance with the United States worsened in 1987, the deficits with the European Economic Community and Japan improved markedly.

Dollar Strengthens

The Canadian dollar appreciated against the U.S. dollar throughout 1987, closing the year at U.S. $0.77, a gain of 4 1/2 cents U.S. The dollar rose a further 2 cents in January and February, bringing the Canadian dollar to over U.S. $0.79 and, by early March, the dollar was consistently above U.S. $0.795. This strong increase in the dollar reflects increased confidence in Canada's economic prospects as well as attractive yields on investment. Since the beginning of 1987, the Canadian dollar has appreciated 8.8% against the U.S. dollar and 5.2% against a trade-weighted (G-10) currency basket (Chart 4).

Chart 4

Canadian Dollar Exchange Rate Against the U.S. and Overseas Currencies



Inflation Continues to Decline

The consumer price index (CPI) advanced 4.1% on a year-over-year basis in January, down slightly from 4.2% in December and well below the 1987 peak of 4.8% posted in June. For the year as a whole, CPI inflation averaged 4.4%. Unit labour cost increases remained moderate throughout 1987, in part as a result of healthy (1.1%) productivity gains. Year-over-year increases in unit labour costs have fallen sharply in the past three quarters to a three-year low of 1.7%. Increased costs of raw materials, especially non-ferrous metals and wood, put some upward pressures on producer prices during the year. At the same time, the appreciation of the Canadian dollar against the U.S. dollar has contained inflationary pressures.

Further Decline in the Unemployment Rate

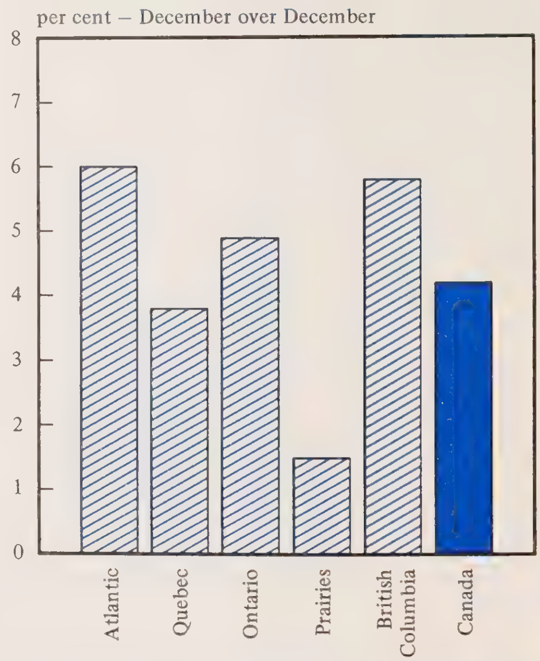
Employment increased by a substantial 486,000 jobs in 1987, the best year of job creation in the 1980s. In spite of a marked increase in labour force growth during the year – the participation rate reached record levels – the unemployment rate dropped 1.6 percentage points over the year to 8.1% in December. Employment gains in 1987 were spread more evenly among industries and regions compared to 1986, with the largest increases in British Columbia and the Atlantic region (Chart 5). In the first two months of 1988, an additional 95,000 jobs were created and the unemployment rate fell to 7.8% in February.

Stock Prices Firming

In the four months following the stock market downturn, stock prices have firmed in both Canada and the United States. The firming of stock prices reflects lower interest rates, renewed institutional purchases and dwindling concerns in the market about a possible recession.

Chart 5

Employment Growth in 1987



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e Economy in Brief

A Quarterly Publication of the Department of Finance

June 1988

Highlights of the First Quarter

- *Real gross domestic product (GDP) increased at an annual rate of 3.4% in the first quarter, a slower pace than in the previous four quarters but higher than previously expected by most forecasters. This continued healthy pace of growth is consistent with the latest OECD projection which places Canada as the second fastest growing of the G-7 economies in 1988.*
- *Consumption and residential construction expenditures were virtually unchanged during the quarter, but real business non-residential expenditure remained buoyant. Canada is expected to register the highest rate of growth in non-residential investment among the G-7 countries in 1988.*
- *The current account deficit dropped to $6.1 billion from $13.4 billion in the previous quarter as a result of a $2.3 billion rise in real net merchandise exports and two events: a large inflow of income from non-residents and a substantial improvement in the balance of travel due to the Calgary Winter Olympics.*
- *Employment rose by 110,000 jobs, or 0.9%, from the end of 1987 to March and by a further 63,000 jobs in April and May. The buoyant labour market was accompanied by rising labour force participation which reached a record rate of 66.9% in May. The unemployment rate in May was 7.8%, down from 8.1% in December 1987.*
- *Consumer price inflation remained around 4.1% in the first five months of the year. Excluding food and energy, prices rose 4.7% on a year-over-year basis.*
- *The Canadian dollar traded at levels above U.S. $0.82 in mid-June and reached above U.S. $0.83 a little later, a gain of close to 6 cents from the end of 1987. A year earlier, the dollar was trading at levels around U.S. $0.75.*

Summary

The Canadian economy continued to grow at a healthy pace in the first quarter. Real GDP moved up at an annual rate of 3.4%, a slower rate than the unsustainably high pace in the previous four quarters, but stronger than generally anticipated at the beginning of the year (Chart 1). Final domestic demand growth slowed considerably, with consumption and housing investment remaining virtually unchanged.

Real GDP growth for 1987 was revised up slightly to 4.0% on an annual average basis. This growth maintains Canada's position as the fastest growing G-7 economy on a cumulative basis since 1984.

The composition of growth of the Canadian economy continued the change apparent during the past year with business non-residential investment assuming a leading role (Chart 2).

Chart 1

Real Gross Domestic Product and Final Domestic Demand

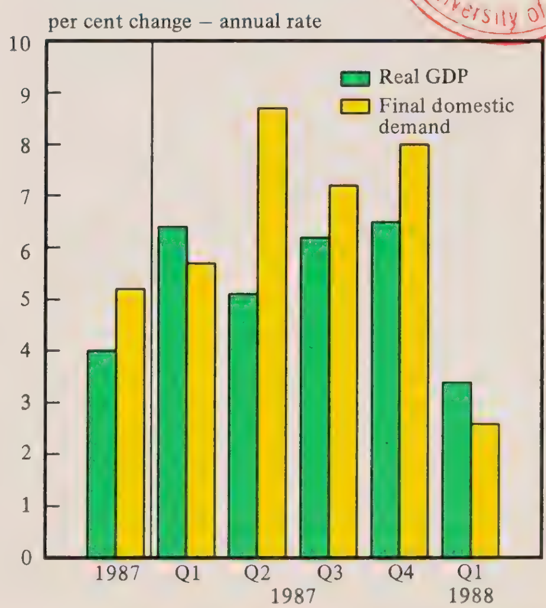

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Chart 2

Contribution of Business Non-Residential Investment to Real Economic Growth

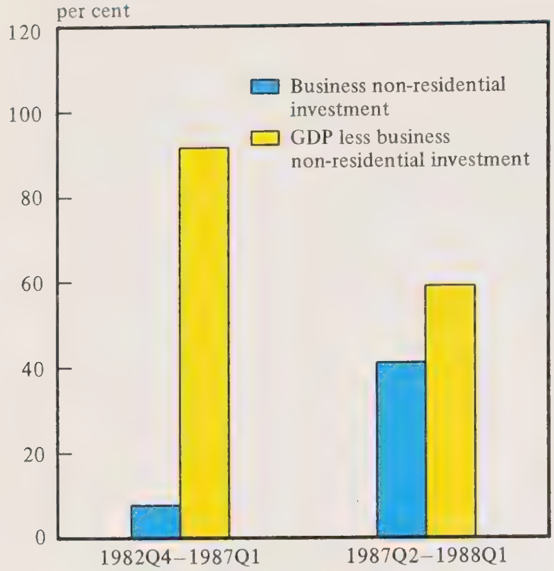
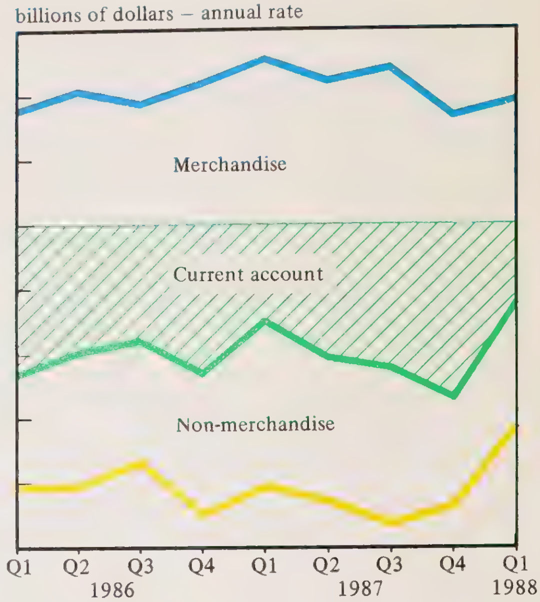


Chart 3

Current Account Balance



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1987				1988
		1986	1987	Q1	Q2	Q3	Q4	Q1
Real gross domestic product		3.2	4.0	6.4	5.1	6.2	6.5	3.4
Final domestic demand		3.8	5.2	5.7	8.7	7.2	8.0	2.6
Consumption		4.3	4.7	5.0	8.0	5.0	6.6	0.2
Residential construction		13.3	15.7	23.1	26.3	15.7	−4.2	−0.2
Business fixed investment		3.2	8.8	3.6	20.3	23.8	28.0	5.9
Non-residential construction		−5.4	1.0	−9.6	25.9	31.6	17.9	1.4
Machinery and equipment		10.6	14.6	13.3	16.8	19.0	35.0	8.9
Business inventory investment	($b,a.r.)	3.4	1.6	0.5	0.7	0.9	4.1	3.3
Non-farm	($b,a.r.)	1.8	1.8	0.5	1.0	0.9	4.7	5.5
Trade balance	($b,a.r.)	13.8	11.5	15.2	11.9	11.5	7.3	10.0
Current account balance	($b, current, a.r.)	−10.5	−10.6	−7.5	−10.3	−11.1	−13.4	−6.1
Incomes								
Real personal disposable income		1.4	3.1	6.8	4.6	0.8	3.8	−4.1
Profits before taxes		−5.4	24.1	22.3	42.0	18.1	18.1	−7.9
Costs and prices	(%,Y/Y)							
GDP price deflator		2.5	4.3	3.8	4.7	4.3	4.4	4.0
Consumer price index		4.1	4.4	4.0	4.6	4.6	4.2	4.1
CPI – energy		−7.1	2.6	−9.8	4.1	8.1	9.9	4.5
CPI – excluding food and energy		5.3	4.6	5.1	4.4	4.4	4.3	4.6
Unit labour costs		3.4	3.5	4.3	4.6	3.3	1.9	2.2
Labour market								
Unemployment rate		9.6	8.9	9.6	9.1	8.7	8.2	7.9
Employment		2.9	2.8	3.3	4.5	2.9	4.9	4.5
Financial developments								
Exchange rate – (end of period)	(U.S. cents)	72.44	76.96	76.60	75.08	76.26	76.96	80.98
Prime interest rate (end of period)		9.75	9.75	8.75	9.50	10.00	9.75	9.75

Sources: Statistics Canada and the Bank of Canada.

Total consumption and housing investment expenditures remained virtually flat in the first quarter while business non-residential investment again expanded strongly although, at 6%, growth in this component in the first quarter was down from around the 25% pace in the three previous quarters. Current surveys indicate growth of business fixed investment in the range of 20% for the year as a whole and show the highest real increase in seven years.

Although consumer spending remained flat during the quarter, consumers maintained a high level of confidence. The Conference Board's Index of Consumer Attitudes rebounded from a decline in the previous quarter which was attributed to the stock market plunge. Residential investment decreased slightly in the first quarter as housing starts declined from their near 10-year peak in mid-1987. However, housing starts remained at a high level and increased to 225,000 on average in April and May.

The external trade sector was the most important contributor to the growth of the economy in the first quarter. The real merchandise trade surplus moved up $2.3 billion to $14.8 billion as exports continued to increase strongly and import growth slowed significantly. Exports of motor vehicles, energy products and wheat were particularly strong. The increase in imports mainly reflected higher imports of machinery and equipment due to the strong growth of business investment.

Employment continued to grow strongly in the first quarter and, by May, 173,000 jobs had been created since the end of 1987. The buoyant labour market spurred labour force participation which reached a record rate of 66.9%. As a result of the strength in employment growth, the unemployment rate reached a 7-year low in April, before increasing marginally to 7.8% in May. Consumer price increases remained around 4.1% in the first five months of the year. However, consumer prices excluding food and energy rose at an annual rate of 5.2% on average in the last three months, down from 5.6% in the previous three month period ending in April.

The Current Account Improves

The slower growth in consumer spending has resulted in slower, but still strong, import growth and, as exports continued to surge, a marked improvement in the current account balance. The current account deficit decreased to $6.1 billion from $13.4 billion in the previous quarter (Chart 3). A sharp $3.8 billion rise in investment income from non-residents contributed significantly to the improvement in the current account balance. As well, the Calgary Winter Olympics were largely responsible for the reduction in the travel account deficit.

Buoyant Business Investment

Real business non-residential investment spending increased at an annual rate of 5.9% in the first quarter. This increase followed growth in the 25% range on average in the last three quarters of 1987. The slowdown in growth was partly due to a downturn in oil and gas drilling activity following the expiration of a provincial drilling incentive program which had spurred drilling in the previous quarter. Investment in machinery and equipment was up by 9% in the first quarter. Capacity utilization remained near its recent peak level of 87%, spurring the demand for investment. Indeed, the March PPI survey indicates investment spending will expand by 17.3% in 1988 following 6.7% growth in 1987. The DRIE survey of investment intentions of large corporations suggests an even larger surge in spending. Because of their current strong financial position, the corporate sector is well poised to realize these investment plans.

Consumption Growth Slows

Real consumer expenditure was virtually flat in the first quarter following four quarters of very strong growth averaging 6% per quarter. The slowdown in spending was broadly based with declines in durable and semi-durable goods offset by small increases in consumption of non-durables and services. The wealth losses from the October stock market downturn may have been a restraining factor on consumer spending. The personal savings rate decreased to

7.5% but the decline was solely due to the manner in which Statistics Canada accounted for the acceleration of source deductions remitted by employers starting at the beginning of the year. Abstracting from the effect of the change in the timing of tax remittances, the personal savings rate would have risen to around 9% during the quarter from 8.3% in the fourth quarter. The timing of these remittances by employers does not affect income available to households for consumption.

Inflation Remained at 4.1%

Since the beginning of the year, the consumer price index (CPI) has posted year-over-year increases averaging 4.1%. This pace of inflation is less than in the last quarter of 1987 and is down significantly from the June 1987 high of 4.8%. Excluding food and energy, however, the CPI was up 4.8% in April and May relative to one year earlier. Unit labour costs rose by 4.2% at annual rates in the first quarter but remained only 2.2% higher than a year earlier. Labour productivity, which grew at an average annual rate of 2.1% per quarter during 1987, declined by 1.0% in the first quarter due to the strength of employment gains. Wage settlements during the quarter averaged 4.0%, similar to the pace that has prevailed since the beginning of 1987.

Buoyant Labour Market

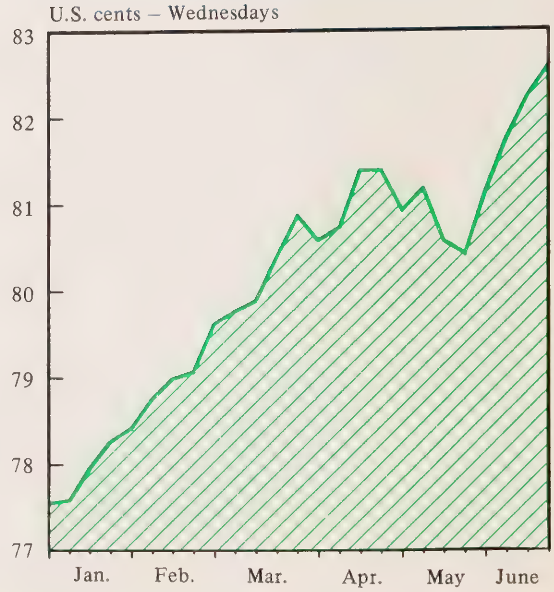
The labour market remained buoyant in the first five months of the year despite a pause in employment growth in March and April. After the creation of 486,000 jobs during 1987, the strongest year of job creation in the 1980s, an additional 173,000 jobs were added in the January to May period. The labour force participation rate reached a record 66.9% in May as the participation rate of women reached a historical high of 57.2% and that of men rebounded to a high of 77.0%. An encouraging feature of the last year and a half is that job creation has become more balanced across all regions of the country.

The Dollar Moved Above U.S. $0.82

The Canadian dollar has appreciated sharply against the U.S. dollar since the beginning of the year (Chart 4). From a closing level of U.S. $0.7699 on December 31, the dollar rose above U.S. $0.82 by mid-June and topped U.S. $0.83 in the following week. Increased confidence in Canadian economic prospects and attractive yields have encouraged inflows of foreign funds into Canada. Short-term interest rates, which had remained fairly stable in May, edged up in June as the Bank rate moved up 37 basis points to 9.49%. The spread between Canadian and U.S. short-term rates, which averaged around 180 basis points in the first quarter, decreased somewhat in May and June to around 160 points.

Chart 4

The Canadian Dollar Since the Beginning of the Year



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

September 1988

Highlights of the Second Quarter

- *In the second quarter, the Canadian economy continued to outperform the expectations of most forecasters, as real gross domestic product (GDP) advanced at a robust annual rate of 3.9%. The strength in the economy was largely domestically based, with final domestic demand rising by 4.8%.*
- *Continued rapid growth in business non-residential investment and a strong rebound in consumer expenditure provided the primary impetus to growth in the quarter. Business non-residential investment has risen at an average annual rate of 18.0% since the end of 1986.*
- *During the first eight months of this year, employment rose 177,000, slightly outpacing the rapid growth in the labour force and the unemployment rate moved between 7.6 and 8.1%. However, the August unemployment rate of 8.0% was down significantly from the 8.7% level in August 1987.*
- *The rate of consumer price inflation fluctuated in a narrow range between 3.8 and 4.1% during the first seven months of 1988. Although growth in unit labour costs remains modest, signals of potential inflation pressure, such as rising private sector wage settlements, are a continuing concern.*
- *Reflecting continuing strong economic growth and growing concern with inflation, interest rates in Canada, as in most other major industrial countries, have risen since the beginning of the year.*

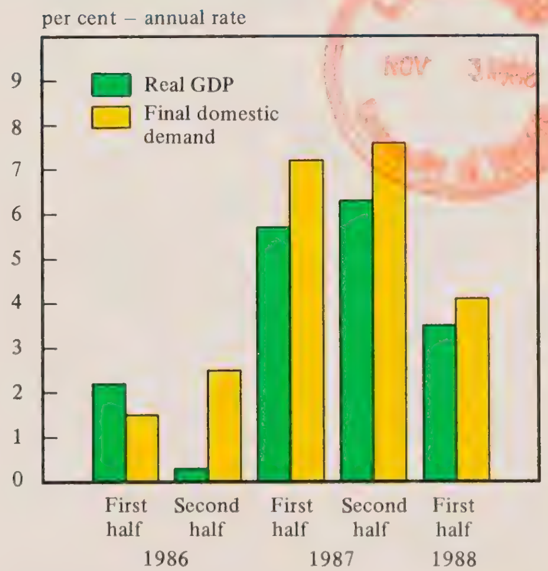
Summary

The economy grew a healthy 3.5% in the first half of the year as final domestic demand increased strongly (Chart 1). Although noticeably slower than the very rapid pace in 1987, real GDP growth of 3.2 and 3.9% in the first and second quarters respectively was much stronger than expected, and exceeds the potential growth rate for the Canadian economy. The more rapid growth in real GDP in the second quarter reflects continued double-digit growth in business investment and a turnaround in consumer expenditure, following a slight decrease in the first quarter.

The housing market remained healthy, as housing starts averaged 228,000 units in the quarter, up sharply from 199,000 in the first quarter. Nevertheless, residential investment decreased slightly as a sharp decline in new housing construction, reflecting the effects of the fall in housing starts in the previous two

Chart 1

Change in Real Gross Domestic Product and Final Domestic Demand



year, underlying cost pressures have shown signs of emerging. The consumer price index (CPI) posted a 3.8% year-over-year increase in July following a 3.9% rise in June and 4.1% average increases during the previous five months. The GDP implicit price deflator for consumption rose sharply in the second quarter but remained only 3.4% higher than a year earlier, reflecting moderate increases in the previous three quarters. Although unit labour costs are only 2.2% higher than one year ago and productivity continues to rise at a healthy pace, private sector settlements have been on an upward trend recently and may be reflected in future cost increases (Chart 3).

The Labour Market Stabilizes

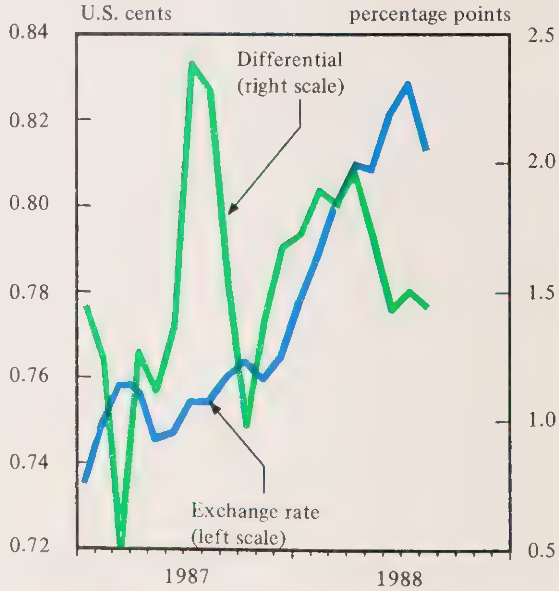
Employment has risen 177,000 since the beginning of the year, an annual growth rate of 2.2%. The labour force has grown at a similar rate, so that the unemployment rate has fluctuated in a range between 7.6 and 8.1% in the first eight months of 1988. However, the average duration of unemployment is down sharply – to 18.0 weeks in August from an average of 20.4 weeks in 1987. Another positive feature of the labour market is the sharp decline in underemployment: the number of people who have part-time jobs because full-time jobs are not available has dropped by 34,000 to 480,000 since 1986.

Interest Rates Up

In response to concern that continued strong economic growth may lead to a resurgence of inflation, short-term interest rates have risen significantly in both Canada and the United States in recent months, although more so in the U.S. than Canada. As a result, the differential on 90-day commercial paper rates has narrowed to around 140 basis points in August from an average of 180 basis points in the first five months of the year (Chart 4). Despite the declining differential in interest rates, the Canadian dollar exceeded U.S. $0.83 in late July and early August, a much higher level than at the end of 1987 when the dollar was trading at U.S. $0.77. More recently, the strength of the Canadian dollar has reversed somewhat and the currency is now trading at around U.S. $0.81.

Chart 4

Canada-U.S. Exchange Rate and 90-Day Commercial Paper Rate Differential



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

December 1988

Highlights of the Third Quarter

- *Real output advanced at an annual rate of 2.6% in the third quarter, following increases of 5.1% on average since the beginning of 1987. Growth in real gross domestic product continued to be domestically based in the third quarter as final domestic demand rose 4.2% with strength in consumer expenditure, business investment and residential construction.*

- *The rate of inflation, as measured by the consumer price index, has remained relatively stable in the 4% range during 1988. Excluding the more volatile food and energy components, however, the rate of inflation has been running close to 5% and private sector wage settlements have exceeded 5% for two consecutive quarters. In response to concerns about the momentum of growth and the associated inflationary pressures, Canadian short-term interest rates are now over 200 basis points above year-end 1987 levels.*

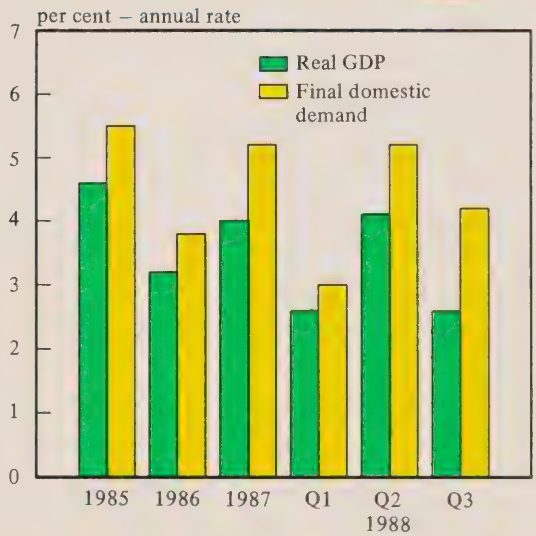
- *Despite a sharp increase in employment of 66,000 in November, the pace of job creation has slowed since May to an average annual rate of 1.3%. The slowdown in employment gains has been accompanied by a similar easing in labour force growth and the unemployment rate has remained relatively stable in the 7.6% to 8% range.*

Summary

Real gross domestic product (GDP) at market prices grew 2.6% in the third quarter, led by sustained strength in final domestic demand. Final domestic demand has grown stronger than real GDP growth in almost every quarter since 1984 (Chart 1). Growth in the third quarter reflected continued strong increases in consumer spending, particularly durable goods, and in business capital outlays. Residential investment rebounded from a decline over the previous three quarters, due to strong growth in new house construction, especially in Ontario and the West. Housing starts averaged 227,000 units at an annual rate during the third quarter, a level well above estimated housing requirements. The real merchandise trade balance deteriorated significantly during the quarter, but due to a further increase in the terms of trade, the

Chart 1

Change in Real GDP and Final Domestic Demand



Canada

Chart 2

The Current Account Deficit

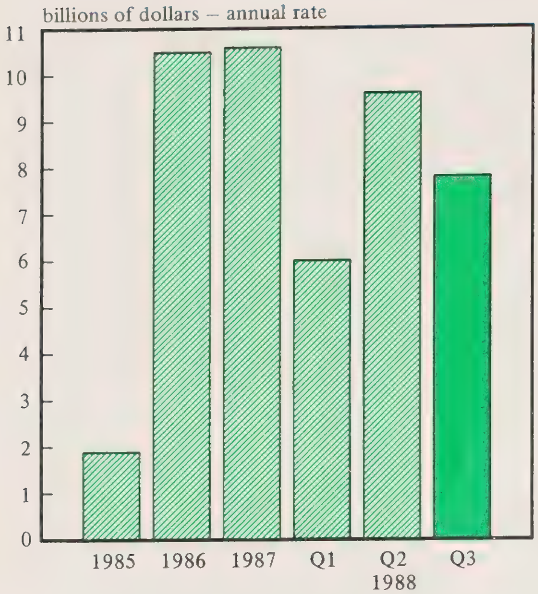


Chart 3

Unit Labour Cost Growth and Private Sector Wage Settlements

Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1987			1988		
		1986	1987	Q2	Q3	Q4	Q1	Q2	Q3
Real gross domestic product		3.2	4.0	5.1	6.2	6.5	2.6	4.1	2.6
Final domestic demand		3.8	5.2	8.7	7.2	8.0	3.0	5.2	4.2
Consumption		4.3	4.7	8.0	5.0	6.6	−0.3	4.1	4.5
Residential construction		13.3	15.7	26.3	15.7	−4.2	0.0	−1.1	4.9
Business fixed investment		3.2	8.8	20.3	23.8	28.0	14.9	15.1	6.1
Non-residential construction		−5.4	1.0	25.9	31.6	17.9	1.6	6.0	7.3
Machinery and equipment		10.6	14.6	16.8	19.0	35.0	24.0	21.0	5.5
Business inventory investment	($b,a.r.)	3.4	1.6	0.7	0.9	4.1	0.0	0.2	0.4
Non-farm		1.8	1.8	1.0	0.9	4.7	4.0	4.0	1.2
Trade balance	($b,a.r.)	13.8	11.5	11.9	11.5	7.3	10.3	8.3	6.9
Current account balance	($b, current, a.r.)	−10.5	−10.6	−10.3	−11.1	−13.4	−6.0	−9.6	−7.8
Incomes									
Real personal disposable income		1.4	3.1	4.6	0.8	3.8	−1.0	3.1	6.3
Profits before taxes		−5.4	24.1	42.0	18.1	18.1	3.4	13.1	16.3
Costs and prices	(%,Y/Y)								
GDP price deflator		2.5	4.3	4.7	4.3	4.4	4.2	3.6	4.4
Consumer price index		4.1	4.4	4.6	4.6	4.2	4.1	4.0	4.0
CPI – energy component		−7.1	2.6	4.1	8.1	9.9	4.5	1.9	−0.7
CPI – excluding food and energy		5.3	4.6	4.4	4.4	4.3	4.6	4.8	4.6
Unit labour costs		3.4	3.5	4.6	3.3	1.9	2.7	2.4	2.9
Labour market									
Unemployment rate		9.6	8.9	9.1	8.7	8.2	7.9	7.7	7.9
Employment		2.9	2.8	4.5	2.9	4.9	4.5	2.0	1.2
Financial developments									
Exchange rate (end of period)	(U.S. cents)	72.44	76.96	75.08	76.26	76.96	80.98	82.41	82.18
Prime interest rate (end of period)		9.75	9.75	9.50	10.00	9.75	9.75	10.75	11.75

Sources: Statistics Canada and the Bank of Canada.

current account deficit decreased substantially to $7.8 billion. The deterioration in the real trade balance since the beginning of the year reflects the strong growth in import-sensitive categories of final demand, such as consumer durables and machinery and equipment investment, and the sharp appreciation of the Canadian dollar against the U.S. dollar since early 1986.

Consumption Growth Picks Up

After a decline in the first quarter, consumer spending regained its previous momentum in the second and third quarters, growing at an average annual rate of 4.3%. Growth in consumer expenditure in the third quarter was supported by a sharp increase in real personal disposable income due, in part, to the personal income tax rate reductions that were reflected in withholding schedules on July 1 as part of Stage One of Tax Reform. Lower import prices, as a result of the appreciation of the Canadian dollar, also contributed to the strong consumer demand. The personal savings rate moved up to 8.4% from 8.0% in the previous quarter and remains in a range consistent with the contractual savings rate. Although consumers continue to be in a relatively healthy financial situation, the low personal savings rate combined with rising consumer debt burdens should restrain consumer spending growth to that of real personal disposable income in the near term.

Continued Strength in Business Investment

After five quarters at an unsustainably strong pace – 17.8% at annual rates – growth in business non-residential investment slowed to 6.1% in the third quarter. Spending on machinery and equipment increased 5.5%, following increases averaging close to 20% since the end of 1986. Non-residential construction posted a 7.3% gain in the third quarter. The strong growth in investment during the quarter was bolstered by a further 16.3% rise in corporate profits before taxes and the need to increase production capacity in response to the high utilization rates prevailing in many industries.

Turnaround in Residential Investment

Residential construction expenditures grew 4.9% in the third quarter, after posting declines over the previous three quarters. The strength in residential investment was the result of increases in new house construction as real spending on alterations and improvements was unchanged and real estate commissions dropped. Housing starts remained above estimated housing requirements during the quarter, reducing further the pent-up demand which has accumulated since the early 1980s as a result of the 1981-1982 recession.

Current Account Balance Improves

The current account deficit declined in the third quarter to $7.8 billion. Thus far in 1988, the current account deficit has averaged $7.8 billion, down significantly from the $10.6 billion deficit recorded in 1987 (Chart 2). The improvement in the third quarter in the current account balance resulted from a strong increase in the merchandise terms of trade (9.8% at annual rates), with export prices of grains, coal, aluminium, zinc and pulpwood all rising during the quarter. The real trade balance, on the other hand, deteriorated further to $6.9 billion, reducing real GDP growth by 1.3 percentage points at annual rates.

Inflation Remains Stable but Pressures Continue

The rate of inflation, as measured by year-over-year changes in the consumer price index (CPI), has fluctuated in a very narrow range over the course of 1988, reaching a low of 3.8% in July and a high of 4.2% in October. The stability of consumer price

inflation is also depicted by the small variations of the GDP fixed-weighted price deflator for consumer goods, which increased at around 3.5% on a year-over-year basis during the first three quarters of 1988. However, to a significant degree the relative stability of consumer price inflation has been due to declines in energy prices. Excluding energy, consumer price inflation is currently running close to 5%. The total GDP implicit deflator rose sharply (5.2% at annual rates) in the third quarter, but this was primarily the result of the substantial improvement in Canada's terms of trade. The fixed-weighted deflator for final domestic demand, which abstracts from terms-of-trade influences, posted a much more moderate gain of 3.8% in the quarter. The GDP deflator in the third quarter was 4.4% above a year earlier.

Unit labour cost increases continued at a moderate pace during the quarter to a level 2.9% above a year earlier (Chart 3). However, private sector wage settlements remained above 5% in the third quarter.

Stable Unemployment Rate

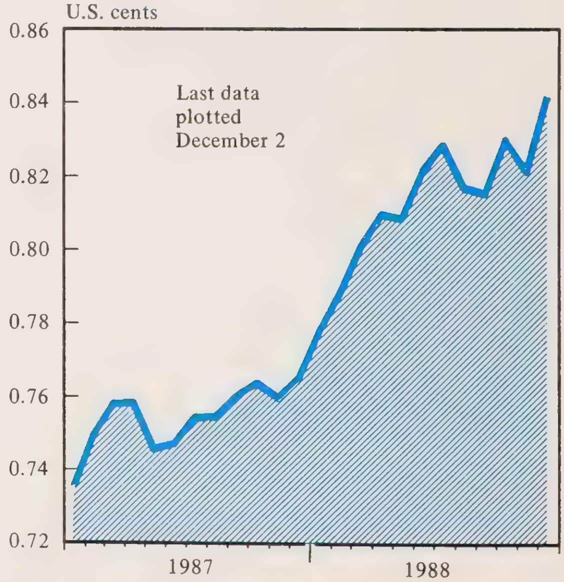
Despite a sharp 66,000 increase in jobs in November, employment growth has on average been modest since May, and the labour force has moved with a similar pattern. As a result, the unemployment rate has remained stable at around 7.8%. Nevertheless, labour markets have tightened appreciably in some parts of the country, particularly in Ontario where the rate of unemployment is at a 14-year low of 5.1%. In addition, the proportion of the labour force affected by unemployment is at record lows.

Short-Term Interest Rates Up

While long-term interest rates have remained relatively stable in 1988, short-term rates have risen steadily in both Canada and the U.S. in response to concerns over the consequences for inflation of the continuing strong pace of economic growth. The short-term interest rate differential between Canada and the U.S. is currently around 160 basis points, down from near 200 basis points earlier this year, but up slightly from the average in 1987. The Canadian dollar, which had been trading in the U.S. $0.81-0.83 range in the July-October period, moved above U.S. $0.84 recently (Chart 4).

Chart 4

Value of Canadian Dollar Since 1987



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

March 1989

Highlights of the Fourth Quarter

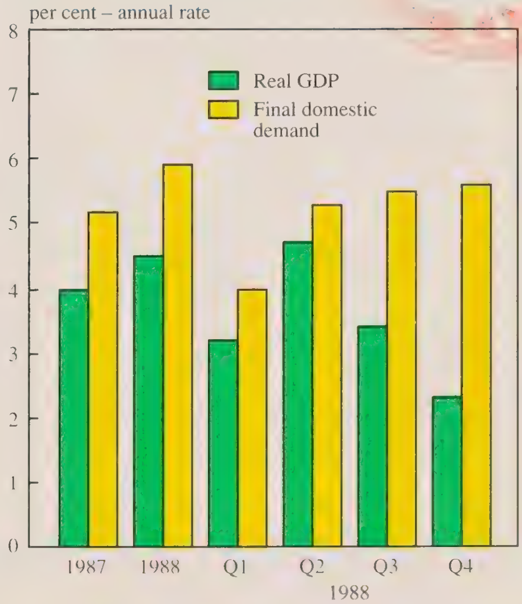
- *While real GDP growth slowed to an annual rate of 2.3% in the fourth quarter, final domestic demand continued to advance at a rapid pace, increasing 5.6% in the quarter. For 1988 as a whole, real GDP grew 4.5%, placing Canada second in terms of growth among the G-7 countries.*
- *The merchandise trade surplus decreased sharply in the fourth quarter as imports soared while exports decreased further. As a result of a marked deterioration in the quarter, the current account deficit increased to $11.3 billion in 1988 from $10.6 billion in 1987.*
- *Inflationary pressures continued to mount through the end of 1988 and early 1989. The implicit deflator for final domestic demand rose in the fourth quarter at an annual rate of 4.6% after increases of below 3% in the previous two quarters. Also of concern is a sharp upturn in unit labour cost growth during the fourth quarter. The year-over-year rate of CPI inflation was 4.3% in January and, excluding food and energy, inflation reached 5.4%.*
- *The labour market was buoyant in the November to February period with 141,000 jobs created. The sharp rise in employment was matched by a proportionate increase in the labour force; as a result, the unemployment rate remained relatively stable at around 7.6%.*

Summary

Real gross domestic product (GDP) at market prices posted a 2.3% gain at an annual rate in the fourth quarter of 1988, down from the 3.8% average annual rate of growth recorded during the first three quarters of the year (Chart 1). However, the slowdown in total output growth concealed the continued underlying strength in final domestic demand, which advanced at an annual rate of 5.6% in the fourth quarter. Since the end of 1986, growth in final domestic demand has averaged 6.2% per quarter. All private sector categories of domestic demand showed strong increases in the fourth quarter. Consumption and residential investment growth picked up significantly while business non-residential investment continued to advance at a very strong pace.

Chart 1

Change in Real GDP and Final Domestic Demand



Real output growth in the fourth quarter was constrained by a marked decline in the real

Chart 2

Nominal Business Non-Residential Investment PPI Intentions, 1989

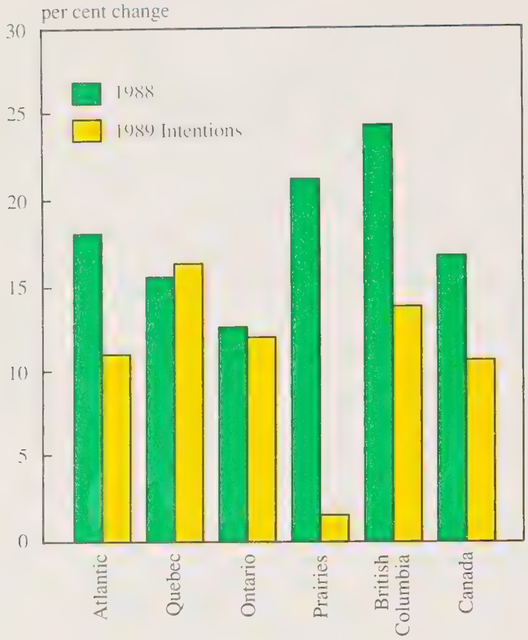
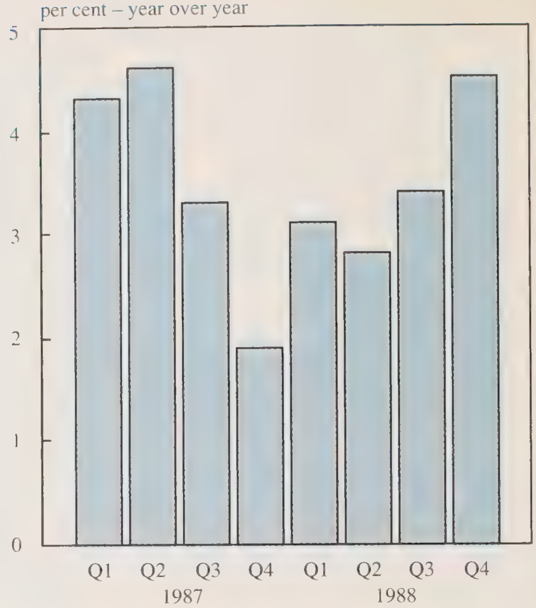


Chart 3

Change in Unit Labour Costs



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1988			
		1987	1988	Q1	Q2	Q3	Q4
Real gross domestic product		4.0	4.5	3.2	4.7	3.4	2.3
Final domestic demand		5.2	5.9	4.0	5.3	5.5	5.6
Consumption		4.7	4.3	0.9	3.8	5.1	6.3
Residential construction		15.7	4.8	3.7	0.7	5.0	10.1
Business fixed investment		8.8	17.8	14.4	16.7	11.3	7.7
Non-residential construction		1.0	11.9	5.5	4.9	8.9	3.1
Machinery and equipment		14.6	21.6	20.4	24.5	12.8	10.5
Business inventory investment	($b,a.r.)	1.6	– 0.1	– 0.4	– 0.4	– 0.8	1.0
Non-farm		1.8	2.5	3.9	3.9	0.6	1.4
Trade balance	($b,a.r.)	11.5	6.7	9.7	8.6	7.5	1.1
Current account balance	($b,current,a.r.)	– 10.6	– 11.3	– 8.1	– 11.2	– 8.6	– 17.1
Incomes							
Real personal disposable income		3.1	3.3	– 0.3	4.6	8.1	6.2
Profits before taxes		24.1	12.7	5.2	13.2	12.2	– 4.4
Costs and prices	(%,Y/Y)						
GDP price deflator		4.3	4.2	4.3	3.7	4.2	4.6
Consumer price index		4.4	4.1	4.1	4.0	4.0	4.1
CPI – energy component		2.6	0.6	4.5	1.9	– 0.7	– 3.1
CPI – excluding food and energy		4.6	4.8	4.6	4.8	4.6	5.0
Unit labour costs		3.5	3.4	3.1	2.8	3.4	4.5
Labour market							
Unemployment rate		8.8	7.8	7.8	7.7	7.8	7.7
Employment		2.9	3.2	4.1	1.8	1.2	1.9
Financial developments							
Exchange rate (end of period)	(U.S.cents)	76.96	83.86	80.98	82.41	82.18	83.86
Prime interest rate (end of period)		9.75	12.25	9.75	10.75	11.75	12.25

Sources: Statistics Canada and the Bank of Canada.

trade balance as imports soared and exports fell for a second consecutive quarter.

Strong Gain in Consumption

Consumer spending increased at an annual rate of 6.3% in the fourth quarter, led by very strong gains in services and non-durable goods purchases. Consumption was supported by a 6.2% increase in real personal disposable income in the fourth quarter, which was bolstered by a sharp 21.3% rise in interest, dividend and investment income and a decline in personal income tax deductions at source associated with Stage One of Tax Reform. The personal savings rate remained largely unchanged at 8.8%, a level roughly consistent with contractual obligations (such as insurance premiums, pension fund contributions and mortgage repayments).

Pickup in Residential Investment

Residential construction investment grew at an annual rate of 10.1% in the fourth quarter, the largest increase since the third quarter of 1987. The strength in residential investment was the result of a 7.1% advance in new construction expenditure, reflecting the strength in housing starts during the last few quarters, continued strong growth in alterations and improvements, and a rebound in real estate commissions after a significant decline in the third quarter. Housing starts averaged above 230,000 units at an annual rate in the fourth quarter and the first two months of 1989, with growth strongest in Ontario and British Columbia.

Business Investment Growth Slowed

After six quarters of growth at an unsustainably strong pace of 19.0% at an annual rate, business non-residential investment growth slowed to 7.7% in the fourth quarter. Business investment in machinery and equipment remained buoyant, advancing 10.5% after increases of 12.8% in the previous quarter and 22.4% in the first half of the year. Non-residential construction growth slowed noticeably to 3.1%, due primarily to declines in oil and gas exploration and development, in response to reductions in federal and provincial government incentive programs.

For this year, Statistics Canada's *Private and Public Investment Intentions Survey* indicates a somewhat slower, but still healthy increase in investment spending. Investment increases are expected to be particularly buoyant in the manufacturing and utilities sectors. Regionally, investment spending intentions are particularly strong in Central Canada, British Columbia and parts of Atlantic Canada (Chart 2).

Trade Surplus Falls Sharply

Continued strong growth in domestic demand, particularly in the import-sensitive categories of machinery and equipment investment and consumer durables spending, led to a pronounced deterioration in the real trade balance in the fourth quarter. As a result, the merchandise trade balance fell sharply in the quarter, despite a modest improvement in the terms of trade. The impact of the fall in the merchandise trade balance on the current account in the fourth quarter was compounded by a \$3.2 billion deterioration in net investment income payments to non-residents, due primarily to one-time large dividend payouts made by a few Canadian companies to foreign shareholders. The current account deficit increased to \$17.1 billion at an annual rate in the quarter and, for 1988 as a whole, the current account deficit widened to \$11.3 billion from an average of \$10.5 billion in the previous two years.

Unemployment Rate Remains Stable

The labour market has been buoyant since late 1988 with 141,000 jobs created over the

November–February period. However, growth in the labour force moved in tandem with employment gains over that period, and the unemployment rate remained relatively stable at around 7.6%. Unemployment rates decreased in all provinces except drought-affected Manitoba and Saskatchewan in 1988. Nationally, the unemployment rate has returned to roughly the level that prevailed on average during the five years prior to the recession.

Inflation Pressure Building

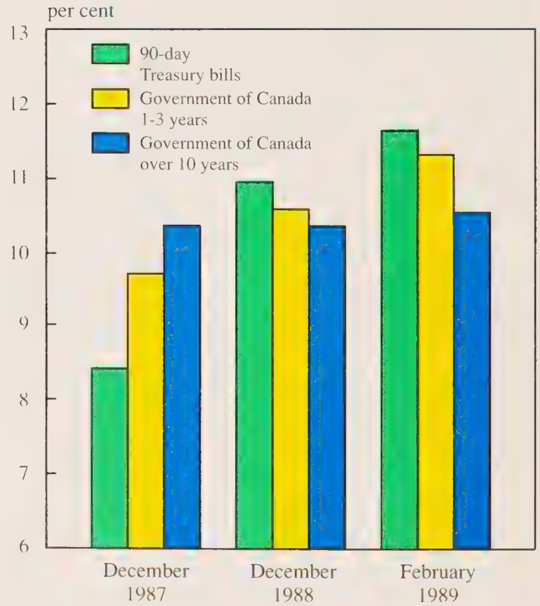
The consumer price index increased 4.3% on a year-over-year basis in January, following increases of around 4.1% in the previous five months. Excluding food and energy, the CPI was up 5.4% in January compared to 5.0% in the fourth quarter and 4.3% in January of 1988. Similarly, most other measures of price inflation have shown significant increases recently. The implicit deflator for GDP rose at an annual rate of 6.3% in the fourth quarter, up significantly from rates of increase of slightly over 4% over the previous four quarters. The deflator for final domestic demand, which excludes terms of trade effects, was up 4.6% in the fourth quarter following increases of less than 3% over the previous four quarters. The marked run-up in most measures of price inflation in the fourth quarter was paralleled by a substantial increase in unit labour costs (Chart 3). A slowdown in productivity growth and continued strong increases in the average wage rate raised unit labour costs sharply in the last quarter of 1988 compared to a year earlier.

Interest Rates Rise Further

Short-term interest rates moved up by over 200 basis points during 1988 in response to strong domestic demand growth and rising inflationary pressures. This upward trend has continued in early 1989. Long-term rates, however, have remained fairly stable with the result that short-term rates are currently over 130 basis points higher than long-term yields (Chart 4). Interest rates in the United States and several other leading industrial countries have moved in a similar fashion, also in response to strong growth and mounting inflationary pressure. Since late 1988, the Canadian dollar has traded in the U.S. $0.83 to $0.845 range.

Chart 4

Short and Long-term Interest Rates (end of period)



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Department of Finance Canada | Ministère des Finances Canada

The Economy in Brief

The Quarterly Economic Review of the Department of Finance

June 1989

Highlights of the First Quarter

- *Real GDP increased 3.8% at an annual rate in the first quarter, led by continued strong growth in residential and non-residential investment. There are signs, however, that growth in demand is slowing from the unsustainably rapid pace of recent years. Growth in consumer expenditures slowed sharply in the first quarter as spending on durables and semi-durables declined. In recent months housing starts, sales and prices have weakened.*

- *Employment growth has slowed since the start of the year. A similar easing in the growth of the labour force has left the unemployment rate relatively unchanged from its year-end 1988 level.*

- *Inflationary pressures remain. The rate of inflation, as measured by the year-over-year change in the consumer price index (CPI), rose from 4.6% in the February to April period to 5.0% in May as increases in federal and provincial excise taxes boosted prices of cigarettes and gasoline.*

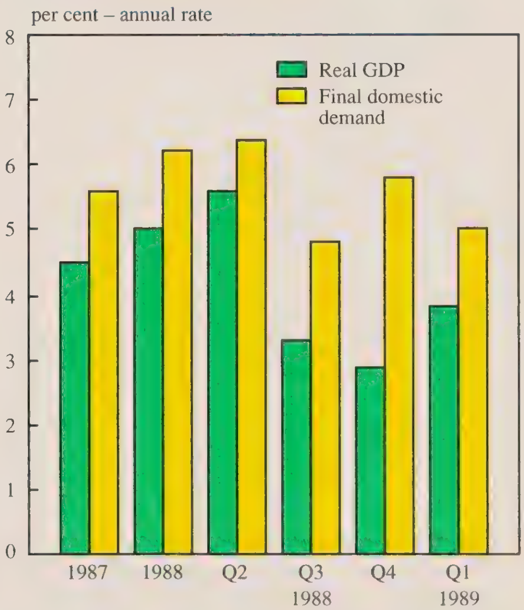
Summary

Real gross domestic product (GDP) at market prices advanced 3.8% at an annual rate in the first quarter of 1989, roughly in line with the rate of increase from the fourth quarter of 1987 to the end of 1988 (Chart 1). Output gains continued to be domestically based, as final domestic demand rose 5.0%. The strong growth in the first quarter also reflected a large increase in farm inventories, as agricultural output is assumed to return to more normal levels in 1989 following the drought of 1988.

Business non-residential investment remained robust, increasing 11.8% despite weakness in oil and gas exploration activity. Residential investment registered a 14.6% advance. The strong growth in domestic demand in Canada led to a large increase in imports, which caused

Chart 1

Change in Real GDP and Final Domestic Demand



Canada

The Economy in Brief

Chart 2

Change in Real Business Fixed Investment

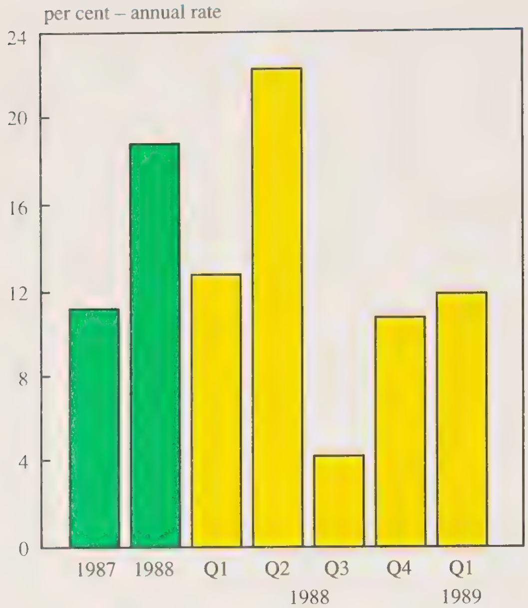
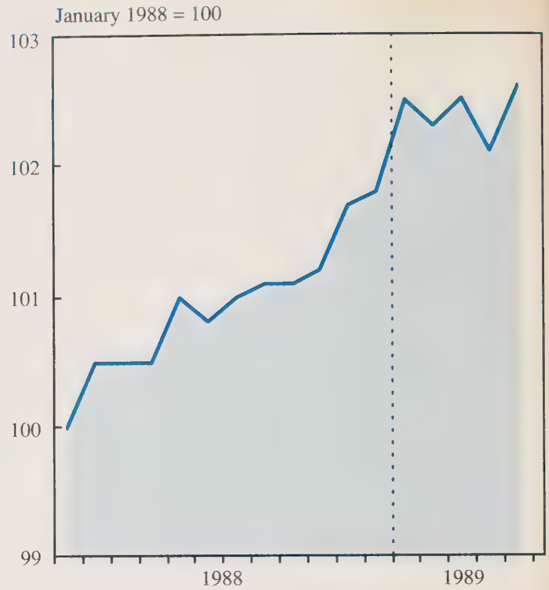


Chart 3

Seasonally Adjusted Employment



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1988			1989
		1987	1988	Q2	Q3	Q4	Q1
Real gross domestic product		4.5	5.0	5.6	3.3	2.9	3.8
Final domestic demand		5.6	6.2	6.4	4.8	5.8	5.0
Consumption		4.9	4.3	3.8	5.0	5.8	1.8
Residential construction		16.4	4.6	– 0.4	0.5	12.0	14.6
Business fixed investment		11.1	18.9	22.3	4.3	10.6	11.8
Non-residential construction		3.3	12.1	3.8	9.3	0.8	8.5
Machinery and equipment		16.6	23.1	34.4	1.6	16.4	13.6
Business inventory investment	($b,a.r.)	0.8	– 0.8	– 2.2	– 1.1	0.0	2.9
Non-farm		1.5	1.7	1.7	1.3	0.3	1.9
Trade balance	($b,a.r.)	11.5	6.9	9.8	6.8	2.0	– 0.2
Current account balance	($b,current,a.r.)	– 9.4	– 10.3	– 8.6	– 10.0	– 15.6	– 14.6
Incomes							
Real personal disposable income		3.9	4.1	4.5	11.3	6.5	7.1
Profits before taxes		24.5	10.7	13.1	10.3	– 10.9	13.8
Costs and prices	(%,Y/Y)						
GDP price deflator		4.4	4.1	2.7	5.7	4.8	6.2
Consumer price index		4.4	4.1	4.0	4.0	4.1	4.5
CPI – energy component		2.6	0.6	1.9	– 0.7	– 3.1	– 1.1
CPI – excluding food and energy		4.6	4.8	4.8	4.6	5.0	5.3
Unit labour costs		4.2	3.8	2.0	4.9	4.6	6.0
Labour market							
Unemployment rate		8.8	7.8	7.7	7.8	7.7	7.6
Employment		2.9	3.2	1.8	1.2	1.9	3.6
Financial developments							
Exchange rate (end of period)	(U.S.cents)	76.96	83.86	82.41	82.18	83.86	83.86
Prime interest rate (end of period)		9.75	12.25	10.75	11.75	12.25	13.50

Sources: Statistics Canada and the Bank of Canada.

the real trade balance to deteriorate significantly. Net exports in real terms were actually negative in the first quarter, for the first time since 1959.

There is evidence that high interest rates are beginning to have a restraining influence on spending behaviour. Consumer expenditure growth slowed considerably in the first quarter as spending on interest-sensitive durable and semi-durable goods declined. Housing starts fell in April and May.

Consumer Spending Slows

Consumer spending increased at a 1.8% annual rate in the first quarter of 1989, down from a 5.8% rate in the fourth quarter of 1988. Spending on durable and semi-durable goods declined slightly. Real personal disposable income grew 7.1% due to strong gains in labour income and large personal income tax refunds. With moderate growth in spending and a strong advance in incomes, the personal savings rate increased to 11.0% from 9.9% in the previous quarter.

Residential Investment Remains Strong

Residential investment continued to grow strongly in the first quarter, advancing 14.6% at an annual rate. The strength was accounted for by large increases in new housing construction and real estate commissions. New housing starts remained relatively stable at 226,000 units at an annual rate in the first quarter, but have since fallen to 189,000 units in May. Although this is the lowest monthly rate since March 1986, it is still slightly above estimates of the growth in demand generated by demographic factors. The strong housing activity of recent years reflects the satisfaction of pent-up demand from the early 1980s.

Business Investment Boom Continues

High capacity utilization rates and healthy corporate balance sheets continue to underpin the strength of business non-residential investment (Chart 2). Spending on machinery and equipment increased at a 13.6% annual rate in the first quarter. Despite weakness in oil and gas exploration, non-residential construction also registered a sizable increase. As a result of the continuing investment boom, business non-residential investment as a share of GDP has risen to 16.5% in the first quarter of 1989 from 12.5% in 1984.

Inventory Investment Increases

The slowing in consumer expenditure growth in the first quarter of 1989 contributed to a build-up in non-farm inventories. Inventory-to-sales ratios, however, remain at relatively low levels by historical standards. The technical assumption by Statistics Canada of a return to normal crop yields from the drought-depressed levels of 1988 resulted in a sharp increase in farm inventories, which added 1.2 percentage points to the annualized real GDP growth rate in the first quarter.

Current Account Deficit Improves Slightly in the First Quarter

The current account deficit improved slightly in the first quarter of 1989 relative to the fourth quarter of 1988. At $14.6 billion, however, the deficit was significantly worse than the $10.3 billion deficit registered for 1988 as a whole. The merchandise trade surplus improved to $9.5 billion in the first quarter, only slightly lower than the surplus for last year. A gain in the terms of trade, however, masked a further deterioration in the real trade balance. The robustness of domestic demand growth in Canada, as well as the strength of the

Canadian dollar, continued to encourage rapid import growth. Imports of machinery and equipment in particular have been growing very rapidly in response to the investment boom under way in Canada. The deficit on non-merchandise transactions continued to widen as rising international interest rates increased interest payments by Canadians to foreigners.

Employment Growth Slows

After a surge in job creation in the November-January period, the level of employment remained relatively constant through May (Chart 3). The stagnation in job creation since January is due to a decline in part-time work offsetting continued strong growth in full-time employment. A moderation in labour force growth has left the unemployment rate relatively stable at about 7 3/4%.

Inflation Up in 1989

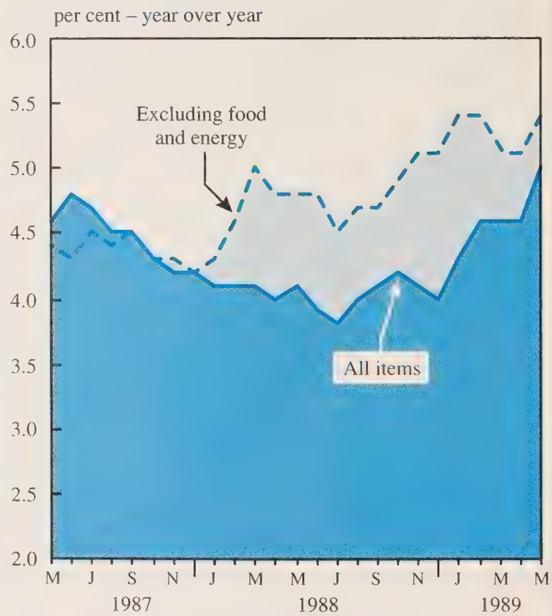
Tightness in national product and labour markets is evident as inflationary pressures remain strong. Profit margins remain high despite a 6.2% rise in labour costs in the first quarter. The consumer price index increased 5.0% in the 12 months to May 1989 (Chart 4). Without the effects of excise tax increases on gasoline and cigarettes, the inflation rate would have remained near 4.6%, the rate prevailing from February to April.

Interest Rates Remain High

After rising through most of 1988 and early 1989, Canadian short-term interest rates have levelled off and in some cases declined slightly since April. The Bank rate eased from a peak of 12.62% at the end of April to 12.31% by early June. The 90-day commercial paper rate has remained relatively stable since April. In the United States, the decline in interest rates has been more pronounced.

Chart 4

CPI Inflation



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

September 1989

Highlights of the Second Quarter

- *Growth in real GDP slowed to an annual rate of 0.6% in the second quarter from 3.3% in the first. A sharp deterioration in real net exports was a major factor underlying the slowing in growth.*
- *Final domestic demand grew 3.4% led by non-residential investment and a rebound in consumer expenditures. Residential investment, on the other hand, declined by 14.7%.*
- *The rate of inflation, as measured by the year-over-year change in the consumer price index (CPI), increased to 5.4% in both June and July. The increase in inflation since May in part reflects indirect tax increases in recent federal and provincial budgets.*
- *Sharp increases in employment in the May to August period have reduced the unemployment rate to 7.4%.*

Summary

Economic growth slowed to an annual rate of 0.6% in the second quarter, compared with 3.3% in the first (Chart 1). The main reason was a sharp deterioration in Canada's net export balance. This reduced the annualized growth rate of real GDP by almost 5.0 percentage points. The current account deficit increased to a record $22.7 billion in the second quarter (Chart 2).

The rate of growth of final domestic demand also slowed in the second quarter, but still remained robust at a 3.4% annualized growth rate. Business fixed investment was once again the leading source of growth in domestic demand, with spending on machinery and equipment up strongly. The strength of investment in machinery and equipment was an important factor in the decline in Canada's trade balance in the second quarter, as imports of

Chart 1

Change in Real GDP and Final Domestic Demand

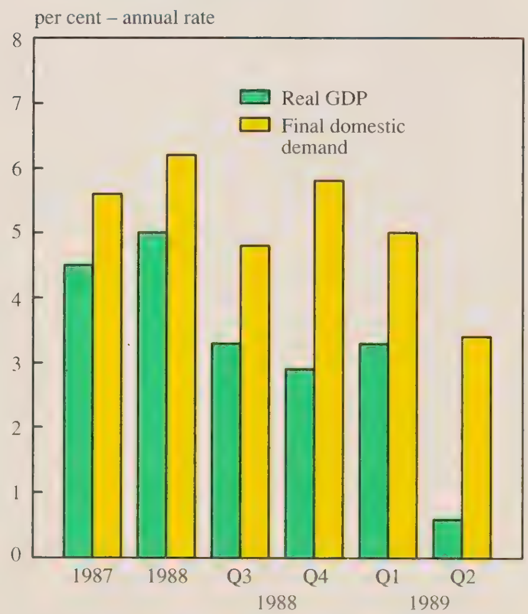


Chart 2

Current Account Deficit

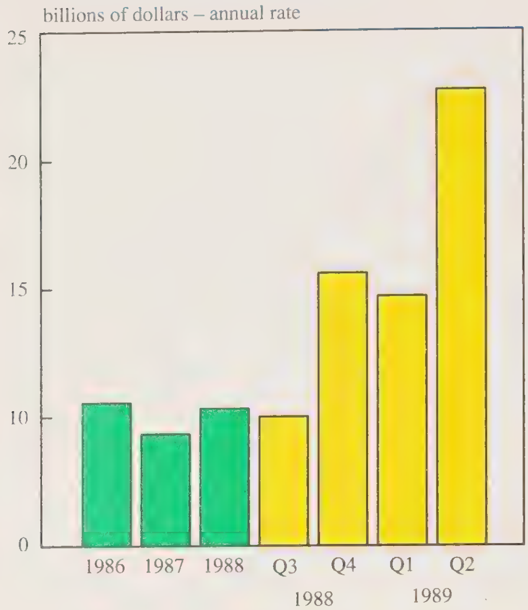
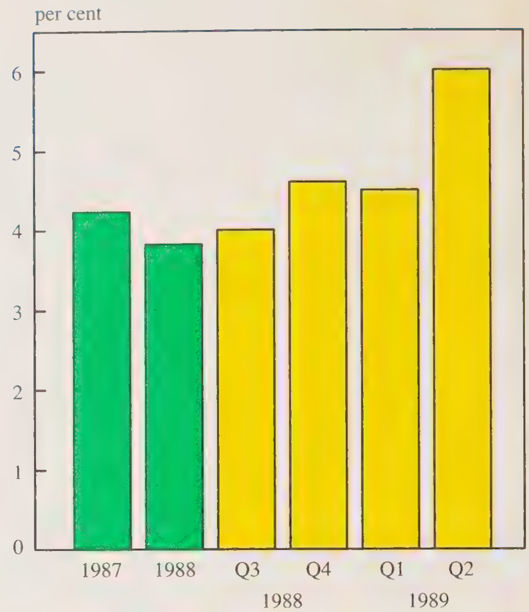


Chart 3

Unit Labour Costs



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1988		1989	
		1987	1988	Q3	Q4	Q1	Q2
Real gross domestic product		4.5	5.0	3.3	2.9	3.3	0.6
Final domestic demand		5.6	6.2	4.8	5.8	5.1	3.4
Consumption		4.9	4.3	5.0	5.8	1.5	5.3
Residential construction		16.4	4.6	0.5	11.9	18.8	– 14.7
Business fixed investment		11.1	18.9	4.3	10.6	12.8	8.8
Non-residential construction		3.3	12.1	9.3	0.8	8.6	1.2
Machinery and equipment		16.6	23.1	1.6	16.4	15.2	13.1
Business inventory investment	($b,a.r.)	0.9	– 0.9	– 1.0	0.0	1.8	4.7
Non-farm		1.5	1.7	1.3	0.3	1.5	2.7
Trade balance	($b,a.r.)	11.5	6.9	6.8	2.0	– 0.7	– 6.3
Current account balance	($b,current,a.r.)	– 9.4	– 10.3	– 10.0	– 15.6	– 14.7	– 22.7
Incomes							
Real personal disposable income		3.9	4.1	11.5	6.6	7.6	– 2.9
Profits before taxes		24.5	10.7	10.3	– 10.9	14.5	– 22.4
Costs and prices	(%,Y/Y)						
GDP price deflator		4.4	4.1	4.2	4.3	5.1	5.6
Consumer price index		4.4	4.1	4.0	4.1	4.5	5.0
CPI – energy component		2.6	0.6	– 0.7	– 3.1	– 1.1	2.5
CPI – excluding food and energy		4.6	4.8	4.6	5.0	5.3	5.4
Unit labour costs		4.2	3.8	4.0	4.6	4.5	6.0
Labour market							
Unemployment rate		8.8	7.8	7.8	7.7	7.6	7.6
Employment		2.9	3.2	1.3	1.9	3.7	0.4
Financial developments							
Exchange rate (end of period)	(U.S.cents)	76.96	83.86	82.18	83.86	83.86	83.55
Prime interest rate (end of period)		9.75	12.25	11.75	12.25	13.50	13.50

Sources: Statistics Canada and the Bank of Canada.

machinery and equipment increased 15.2%. Consumer spending rebounded in the second quarter, supported by large gains in disposable income in the first half of the year, as well as buyer rebate and incentive programs in the automobile sector early in the quarter. Residential investment, on the other hand, declined by 14.7%, as real estate commissions fell in response to weakening in the resale housing market in the second quarter. Both farm and non-farm business inventories were up in the second quarter, together adding 2.6 percentage points to the annualized growth rate of GDP.

Consumer Spending Rebounds in Second Quarter

After a modest 1.5% increase in the first quarter of 1989, growth in consumer spending rebounded to 5.3% in the second quarter. Solid gains in disposable income over the first half of 1989, due in part to larger than usual income tax refunds stemming from the 1988 income tax reform, underlay the strength in household spending. Strong automobile purchases reflected buyer rebate and incentive programs that were in effect early in the second quarter. More recent evidence points to a slowing in consumer spending in the second half of 1989. After some of the rebate and incentive programs lapsed, passenger car sales fell in May, June and July. A sharp drop in the Conference Board's Index of Consumer Attitudes in the second quarter suggests that spending on "big ticket" items will weaken.

Residential Investment Declines

Residential investment declined 14.7% at an annual rate in the second quarter as real estate commissions were down sharply from the first quarter, reflecting the marked deterioration in the resale housing market. The annualized rate of new housing starts declined from 226 thousand units in the first quarter to 208 thousand in the second. In the third quarter, starts have weakened further, to about 203 thousand on average in July and August.

Robust Investment Continues

Non-residential investment registered another strong gain in the second quarter, advancing 8.8% after a 12.8% increase in the first quarter. Machinery and equipment accounted for most of the second quarter increase, rising 13.1%. Investment prospects look strong for the remainder of the year. The mid-year survey of Private and Public Investment Intentions published in July indicated that businesses have revised their investment intentions for 1989 upward since the start of the year. Businesses plan to increase spending by 13.6% in nominal terms according to the latest survey, compared with 10.6% in the previous survey, published in March. The confidence about economic prospects which is evident in this Statistics Canada survey contrasts with the decline in business confidence shown in the most recent Conference Board of Canada Index of Business confidence, even though the two surveys were carried out at the same time.

Trade Balance Deteriorates Sharply

Real net exports declined from a deficit of $0.7 billion (1981 dollars) in the first quarter to a deficit of $6.3 billion in the second. This decline was concentrated in merchandise trade, which fell from a surplus of almost $5.5 billion (1981 dollars) in the first quarter to about $0.5 billion in the second. A strong gain in imports of machinery and equipment underlay much of this deterioration. The impact of the strong dollar, however, is evident in the recent weak growth of Canada's exports. In total, real exports in the second quarter were down 1.5% compared with the second quarter of last year. Even abstracting the drought-depressed grain sector, exports were up only 1.4% over the same period. The current account deficit in the second

quarter widened to a record $22.7 billion from $14.7 billion in the first quarter. As a share of GDP, the current account deficit was 3.5%, the highest level since the late 1950s.

National Labour Market Remains Tight

After sluggishness earlier in the year, employment growth rebounded over the May to August period, pushing the unemployment rate down to 7.4% in August. Other indicators also bolster the impression of a tight national labour market. The average work week has increased over the last two years; employment-population and help-wanted indexes are at historically high levels; and the number of discouraged job seekers is at a record low.

Inflation Rate Increases

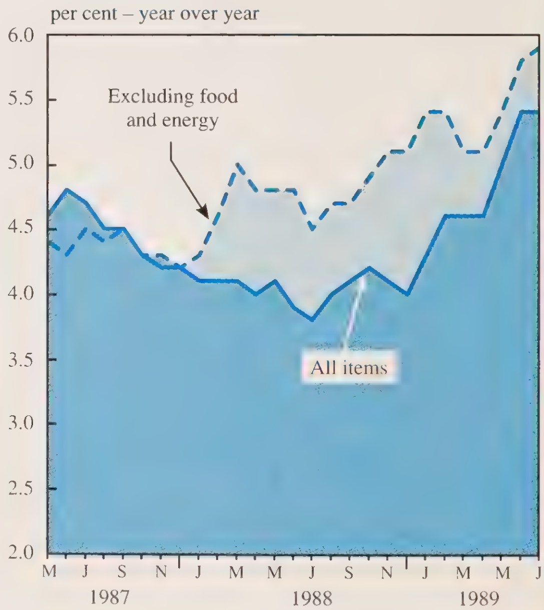
The inflation rate moved up to 5.0% in May and to 5.4% in June and July, compared with 4.6% over the February to April period. Indirect tax increases implemented in the recent federal and provincial budgets contributed to the rise in May and June. The tightness in labour markets is evident in recent labour cost data. Unit labour costs in the second quarter were up 6.0% over the same period last year. The economy-wide wage rate was up by 6.8% on a year-over-year basis in the second quarter, compared with a 6.2% increase in the first quarter. Wage increases reached in major collective agreements were also up substantially in the second quarter.

Interest Rates Remain Stable

Short-term interest rates in Canada have remained stable since March. U.S. rates, on the other hand, have continued to move down, and by the end of August, the differential between Canadian and U.S. short-term rates had widened to 334 basis points (90-day commercial paper). After moving down through February to June, long-term rates in Canada have recently been stable. The Canadian dollar rose to over U.S. $0.85 in early August, but fell back to just over U.S. $0.84 by early September.

Chart 4

CPI Inflation



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

December 1989

Key Messages

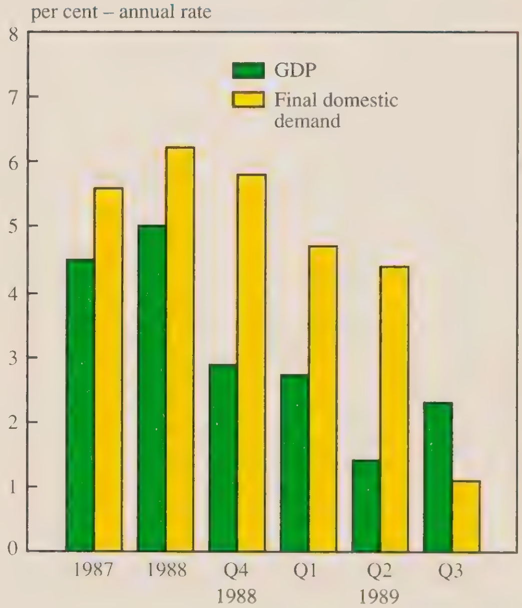
- *Growth in real GDP continued at a modest pace in the third quarter, rising to 2.3% from 1.4% in the second quarter. Despite the modest pace of economic growth, the level of economic activity remains high relative to the economy's potential to supply goods and services.*
- *The third quarter witnessed a marked change in the composition of output growth. Final domestic demand, after increases in the range between 4 and 6% from 1985 through the first half of this year, slowed significantly in the third quarter. The real trade balance contributed positively to output growth in the third quarter for the first time since the first half of 1988. This led to an improvement in the current account deficit, although it remained at a very high level.*
- *The rate of inflation, as measured by the year-over-year change in the CPI, eased to 5.1% in October, down from the June–July peak of 5.4%. Nevertheless, underlying cost pressures remain strong. Unit labour costs are up 5.8% on a year-over-year basis in the third quarter and wage settlements have continued to rise.*

Summary

Economic growth rose to 2.3% in the third quarter from 1.4% in the second. An improvement in real net exports more than compensated for a lower growth rate of final domestic demand (Chart 1).

Chart 1

Change in Real GDP and Real Final Domestic Demand



The slowing in final domestic demand growth was caused by declines in the interest-sensitive categories of consumer goods spending and machinery and equipment investment. Spending in other interest-sensitive sectors, such as housing, however, remained strong. New housing starts remained above 200 thousand at an annual rate.

Exports declined in the third quarter due to both slow growth in domestic demand in the United States and the high value of the Canadian dollar. Imports declined even more, however, reflecting

The Economy in Brief

Chart 2

CPI Inflation

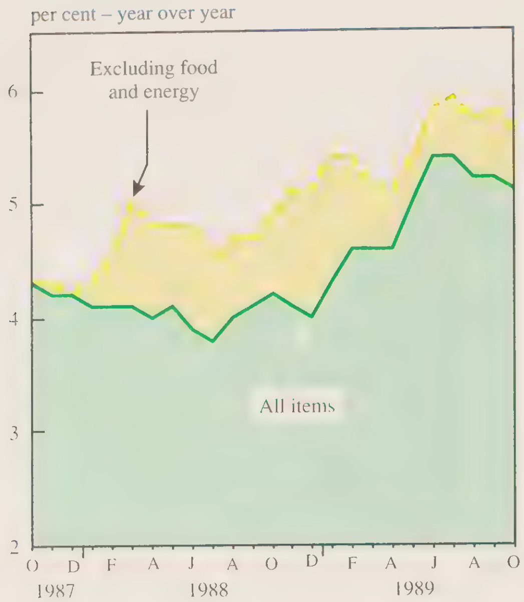
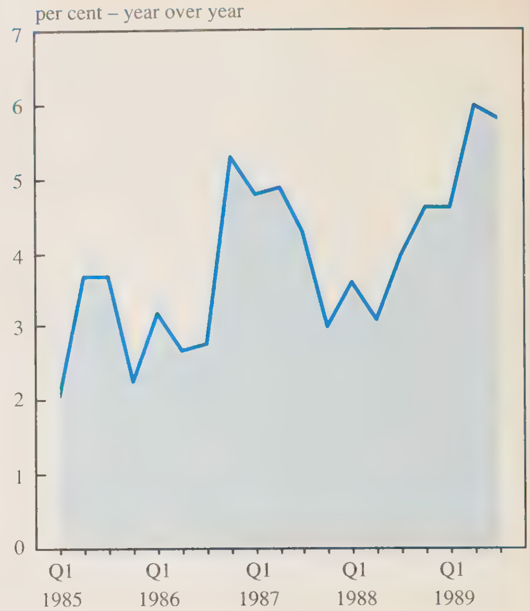


Chart 3

Unit Labour Costs



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1988	1989		
		1987	1988	Q4	Q1	Q2	Q3
Real gross domestic product		4.5	5.0	2.9	2.7	1.4	2.3
Final domestic demand		5.6	6.2	5.8	4.7	4.4	1.1
Consumption		4.9	4.3	5.8	1.5	5.4	– 0.0
Residential construction		16.4	4.6	11.9	13.5	– 11.9	1.1
Business fixed investment		11.1	18.9	10.6	14.7	11.5	2.7
Non-residential construction		3.3	12.1	0.8	4.4	4.1	10.6
Machinery and equipment		16.6	23.1	16.4	20.6	15.5	– 1.2
Business inventory investment	($b,a.r.)	0.9	– 0.9	0.0	1.5	3.9	3.3
Non-farm		1.5	1.7	0.3	0.8	1.8	1.7
Trade balance	($b,a.r.)	11.5	6.9	2.0	– 0.8	– 5.7	– 4.7
Current account balance	($b,current,a.r.)	– 9.4	– 10.3	– 15.6	– 15.0	– 21.6	– 18.8
Incomes							
Real personal disposable income		3.9	4.1	6.6	8.2	– 2.2	1.9
Profits before taxes		24.5	10.7	– 10.9	14.7	– 18.3	– 5.4
Costs and prices	(%,Y/Y)						
GDP price deflator		4.4	4.1	4.3	5.1	5.5	4.5
Consumer price index		4.4	4.1	4.1	4.5	5.0	5.3
CPI – energy component		2.6	0.6	– 3.1	– 1.1	2.5	5.4
CPI – excluding food and energy		4.6	4.8	5.0	5.3	5.4	5.8
Unit labour costs		4.2	3.8	4.6	4.6	6.0	5.8
Labour market							
Unemployment rate		8.8	7.8	7.7	7.6	7.6	7.4
Employment		2.9	3.2	1.9	3.6	0.4	2.8
Financial developments							
Exchange rate (end of period)	(U.S.cents)	76.96	83.86	83.86	83.86	83.55	84.95
Prime interest rate (end of period)		9.75	12.25	12.25	13.50	13.50	13.50

Sources: Statistics Canada and the Bank of Canada.

the slowing in domestic demand growth in Canada.

The CPI inflation rate eased in the third quarter, though pressure from labour costs continued to build. Sluggish demand growth and increasing labour costs led to a second consecutive quarterly decline in corporate profits.

Consumer Spending Flat in Third Quarter

Consumer spending was unchanged in the third quarter after a strong 5.4% increase in the second quarter. Spending on all categories of goods fell in the third quarter, with automobile purchases exhibiting the most pronounced decline. A weakening in consumer spending in the third quarter was to be expected, since strength in the second quarter was exaggerated by a number of special factors, including the unusual timing of tax refunds this year due to income tax reform, as well as buyer incentive programs in the automobile industry. The personal saving rate increased to 9.7% in the third quarter from 9.4% in the second.

Rebound in House Sales Boosts Residential Investment

Residential investment grew 1.1% at an annual rate in the third quarter following a sharp decline in the second. The third quarter increase was due mainly to a rebound in real estate commissions, as house sales strengthened in response to lower mortgage rates. Housing starts rose slightly to 215 thousand units (annual rate) in the third quarter from 208 thousand in the second.

Machinery and Equipment Spending Weakens

Total business non-residential investment increased 2.7% in the third quarter. Business spending on machinery and equipment, however, fell 1.2% in the third quarter, the first quarterly decline in five years. The third quarter decline makes it likely that spending on machinery and equipment in 1989 will fall short of the revised projections in Statistics Canada's mid-year Survey of Private and Public Investment in Canada. With the strong growth in previous quarters, however, machinery and equipment spending was still up 12.5% over the third quarter of last year and investment in machinery and equipment as a share of GDP remains near an historic high. Non-residential construction registered a strong gain in the third quarter, increasing 10.6%.

Net Exports Increase

Real net exports improved in the third quarter, thus adding to real GDP growth for the first time in over a year. Imports declined 4.0%, reflecting the slowing in domestic demand in Canada. Exports fell 1.7% due to both the high value of the Canadian dollar and the slow growth of domestic demand in the United States. The improvement in net exports, plus an increase in net inflows of immigrants' funds, led to a decline in the current account deficit from $21.6 billion in the second quarter to $18.8 billion in the third.

Employment Growth Continues

Employment continues to register solid gains in 1989. Compared with the end of 1988, employment in November was up by 216 thousand jobs. The largest gains in employment were realized in British Columbia. Employment growth slowed in Central Canada in 1989, but lengthened workweeks and frequency of overtime hours suggest this slowing was the result of a limited supply of labour rather than slackening demand.

Inflation Rate Eases

The CPI inflation rate peaked at 5.4% in June and July and has since eased somewhat. In October, the rate was 5.1%, down from 5.2% in

September and August (Chart 2). The inflation rate excluding the volatile food and energy components fell to 5.6% in October from a July high of 5.9%. Prospects for further improvements in inflation are threatened, however, by an acceleration in labour costs. Wage settlements increased to 5.9% in the third quarter, the largest increase in six years. Settlements in some provincial administrations were particularly large. Unit labour costs in the third quarter were up 5.8% from the same quarter last year.

Profits Decline for Second Consecutive Quarter

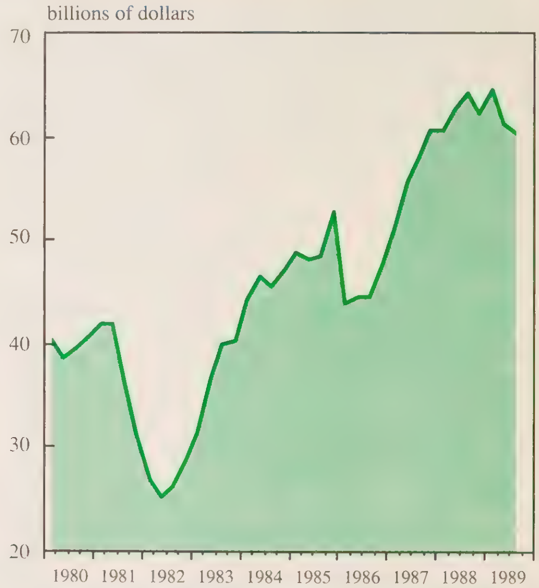
Reflecting the squeeze on profit margins caused by both rising labour costs at a time of slowing demand and the strong Canadian dollar, corporate profits declined 5.4% at an annual rate in the third quarter. This was the second consecutive quarterly decline (Chart 4). Profits now stand 5.7% below their level in the third quarter of last year.

Canadian Interest Rates Stable

Canadian short- and long-term interest rates have remained more or less unchanged since March. U.S. short-term interest rates eased slightly in November. The interest differential between Canadian and U.S. 90-day commercial paper widened to 380 basis points by the beginning of December, contributing to the strength of the Canadian dollar against its U.S. counterpart. By December 8, the Canadian dollar was trading just above U.S. $0.86, compared with just under U.S. $0.85 in September.

Chart 4

Pre-Tax Corporate Profits



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

March 1990

Key Messages

- *Real GDP, led by a robust gain in final domestic demand, advanced 2.0% at an annual rate in the fourth quarter, considerably exceeding the expectations of virtually all economic forecasters.*
- *Growth in domestic demand continues to outpace the growth in the economy's capacity to produce. This has led to a continuing surge in import growth and a further deterioration in Canada's net trade position.*
- *While the inflation rate increase in January was due to special factors, inflation pressures remain intense. Unit labour costs continued to accelerate in the fourth quarter, reflecting the strength of demand and tight conditions in national labour markets.*

Summary

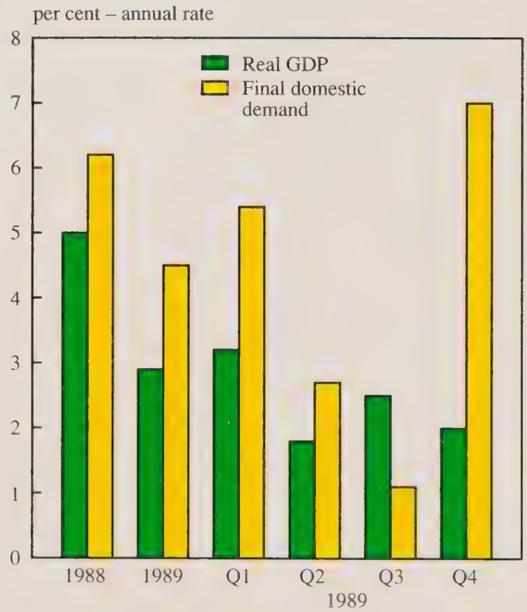
The economy grew at an annual rate of 2.0% in the fourth quarter, down slightly from the 2.5% rate in the third (Chart 1). A strong rebound in final domestic demand was partially offset by declines in real net exports and inventory investment. For 1989 as a whole, real growth averaged 2.9%.

The fourth-quarter rebound in domestic demand included both consumer spending on durable goods and business spending on machinery and equipment. Strong housing sales and new construction produced a solid gain in residential investment.

Weaker growth in the United States economy and the higher value of the Canadian dollar led to a decline in real exports in the fourth quarter. The strong growth in domestic demand in Canada, on the other hand, contributed to a sharp increase in imports.

Chart 1

Change in Real GDP and Real Final Domestic Demand



Canada

Chart 2

Nominal Business Non-Residential Investment Intentions (PPI)

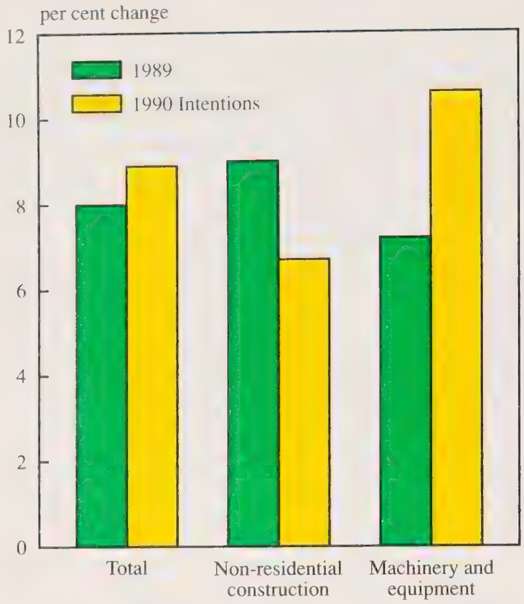
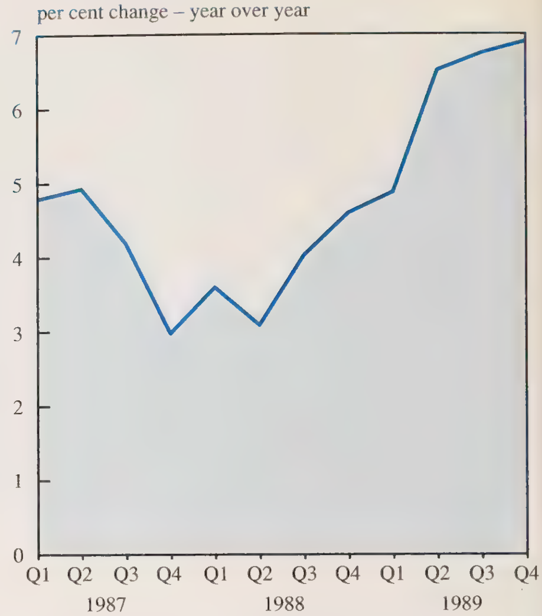


Chart 3

Unit Labour Costs



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1989			
		1988	1989	Q1	Q2	Q3	Q4
Real gross domestic product		5.0	2.9	3.2	1.8	2.5	2.0
Final domestic demand		6.2	4.5	5.4	2.7	1.1	7.0
Consumption		4.3	4.0	2.6	4.6	1.7	5.4
Residential construction		4.6	4.1	15.1	– 16.5	6.4	15.5
Business fixed investment		18.9	8.2	14.3	6.3	– 7.2	11.4
Non-residential construction		12.1	3.6	6.6	– 2.7	6.6	2.9
Machinery and equipment		23.1	10.7	18.6	11.3	– 13.7	16.2
Business inventory investment	(1981 $b,a.r.)	– 0.9	3.5	0.7	4.5	5.1	3.9
Non-farm		1.7	2.6	0.3	2.7	3.5	3.9
Trade balance	(1981 $b,a.r.)	6.9	– 5.0	– 0.6	– 5.4	– 5.0	– 9.1
Current account balance	($b,current,a.r.)	– 10.3	– 19.7	– 14.9	– 20.8	– 20.5	– 22.3
Incomes							
Real personal disposable income		4.1	5.5	8.4	– 0.9	3.9	3.5
Profits before taxes		10.7	– 2.8	14.0	– 20.6	– 6.5	– 13.3
Costs and prices	(%,Y/Y)						
GDP price deflator		4.1	4.9	5.0	5.2	4.7	4.5
Consumer price index		4.1	5.0	4.5	5.0	5.3	5.2
CPI – energy component		0.6	3.5	– 1.1	2.5	5.4	7.0
CPI – excluding food and energy		4.8	5.5	5.3	5.4	5.8	5.5
Unit labour costs		3.8	6.3	4.9	6.5	6.7	6.9
Labour market							
Unemployment rate		7.8	7.5	7.5	7.6	7.4	7.6
Employment		3.2	2.0	3.3	0.6	2.4	0.8
Financial developments							
Exchange rate (end of period)	(U.S.cents)	83.86	86.47	83.86	83.55	84.95	86.47
Prime interest rate (end of period)		12.25	13.50	13.50	13.50	13.50	13.50

Sources: Statistics Canada and the Bank of Canada.

The inflation rate increased to 5.5% in January due to a number of special factors, including the effects of cold weather on food and energy prices and indirect tax increases. Unit labour-cost inflation rose to 6.9% in the fourth quarter from 6.7% in the third. The four-quarter rate of increase in the implicit GDP deflator eased to 4.5% in the fourth quarter from 4.7% in the third. For 1989 as a whole, the GDP deflator was up 4.9%, compared with 4.1% in 1988.

Consumer Spending Up in Fourth Quarter

Consumer spending rebounded sharply in the fourth quarter as all major components of consumer expenditure except semi-durables recorded strong gains. In particular, spending on automobiles and parts increased even though sales of new motor vehicles declined. Also, spending on non-durables jumped as cold weather in December prompted heavy consumption of heating fuels. The financial position of households deteriorated further in the fourth quarter; both personal debt and interest costs rose as a share of disposable income.

Strength in Housing Continues

Residential investment increased an impressive 15.5% in the fourth quarter. Real estate commissions generated by strong sales led the advance, increasing at an annual rate of over 70%. New housing construction was also up in the second half of the year. For the whole year, housing starts totalled 215 thousand, down only slightly from the 1988 total of 223 thousand. In the first two months of 1990, housing starts remained around an annual rate of 220 thousand. The strength in housing has been increasingly concentrated in British Columbia and Alberta. Housing markets in Central Canada weakened in both 1988 and 1989.

Investment Strong in Fourth Quarter

Business spending on machinery and equipment rebounded in the fourth quarter, leading an 11.4% real increase in business non-residential investment. Non-residential construction gained a moderate 2.9%. Strong growth in investment in recent years has led to a rapid expansion of the capital stock. In the face of weakening demand, capacity utilization rates have been declining. Despite this decline and deteriorating profit performance, investment intentions have not slowed. The latest Private and Public Investment Intentions Survey shows a planned increase of 8.9% in nominal terms in 1990, up from an 8.0% increase in 1989 (Chart 2).

Inventories Under Close Control

The rate of non-farm inventory accumulation was up slightly in the fourth quarter. The aggregate inventory-to-sales ratio rose in the fourth quarter, but remains near its historical trend. Business appears to be pacing production carefully to keep it in line with demand and avoid excessive build-up of inventories. The rate of farm inventory accumulation was down sharply in the fourth quarter, as wheat exports rebounded.

Unemployment Rate Rising

Employment growth slowed in the fourth quarter and first two months of 1990. Continuing labour force growth caused the unemployment rate to edge up from 7.4% in September to 7.8% in January before easing to 7.7% in February. Despite the rise in the unemployment rate, other indicators of the state of the labour market point to continuing tightness. The number of workers forced to work part-time because of the unavailability of full-time employment remains low, and the Help Wanted Index, though down in recent months, is still above its historical average.

Inflation Pressures Remain

The CPI inflation rate eased during the second half of 1989, but jumped to 5.5% in January in response to food and energy price increases

caused by the December cold weather as well as federal and provincial indirect tax increases. The inflation rate excluding the volatile food and energy components was 5.4% in January, the same as in both November and December. For 1989, the inflation rate was 5.0%, up from 4.1% in 1988. Without the appreciation of the Canadian dollar in 1989, however, the inflation rate would have been over 6.0%. Unit labour costs increased at a year-to-year rate of 6.9% in the fourth quarter (Chart 3).

Profits Down Again in Fourth Quarter

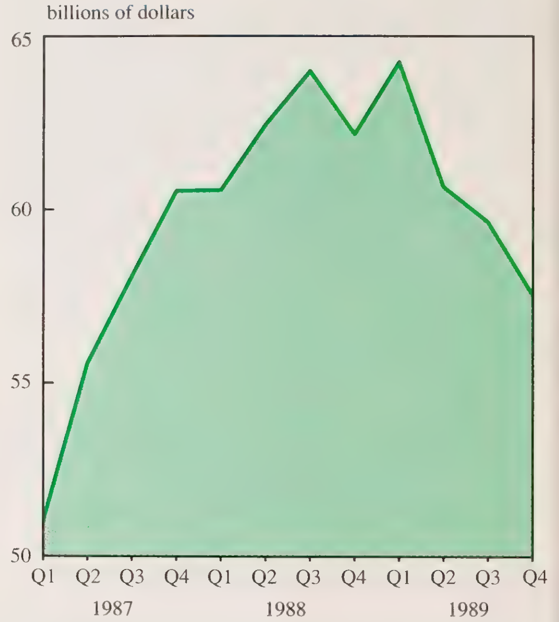
Corporate profits ended the year with a third consecutive quarterly decline, and were 7.4% below the level of the fourth quarter of 1988 (Chart 4). The decline in profits through 1989 reflected slower output growth, higher labour costs, and the effects of the strong Canadian dollar.

Volatility in Financial Markets

Financial markets in Canada were somewhat volatile in January and February. After declining in mid-January, short-term interest rates have increased. The Bank Rate on March 8 was 13.31%, compared with 12.44% in early January. Long-term interest rates have risen in most industrialized countries in response to rising inflation fears. The external value of the Canadian dollar fell sharply in January but has since recovered to about U.S. $0.85.

Chart 4

Corporate Profits Before Taxes



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

June 1990

Key Messages

- *The growth of domestic demand slowed significantly in the first quarter of 1990. This should help to relieve some of the inflation pressures which have built up in the economy. The level of economic activity, however, remains high.*
- *While the inflation rate has declined in recent months, to a large degree this is due to declining profit margins and the passing of the one-time effects of indirect tax increases introduced in federal and provincial budgets last year.*
- *Underlying cost pressures continue to build, as evidenced by the further sharp increase in unit labour costs. In the first quarter of 1990, unit labour costs were up 6.4% compared to the same period a year ago.*

Summary

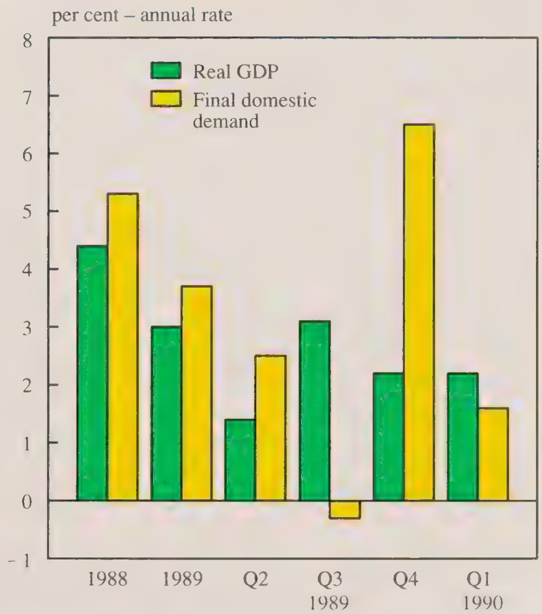
The economy grew at a 2.2% annual rate in the first quarter, the same rate as in the fourth quarter of 1989. Growth in domestic demand slowed sharply, to 1.6% from 6.5% in the last quarter of 1989 (Chart 1).

These developments indicate that tight monetary conditions and fiscal restraint have begun to have a dampening effect on aggregate spending. Concerns about financial positions are evident in the spending behaviour of both the household and business sectors. On the other hand, there are factors which should militate against a strong downturn in activity. Businesses have avoided a large build-up of inventories. Growth remains strong in foreign economies, which should help Canadian exports.

Measures of inflation at the consumer level, such as the consumer price index (CPI), have moderated in recent months. Underlying cost pressures continue to build, however, as tightness

Chart 1

Change in Real GDP and Final Domestic Demand



Canada

Chart 2

Unit Labour Costs

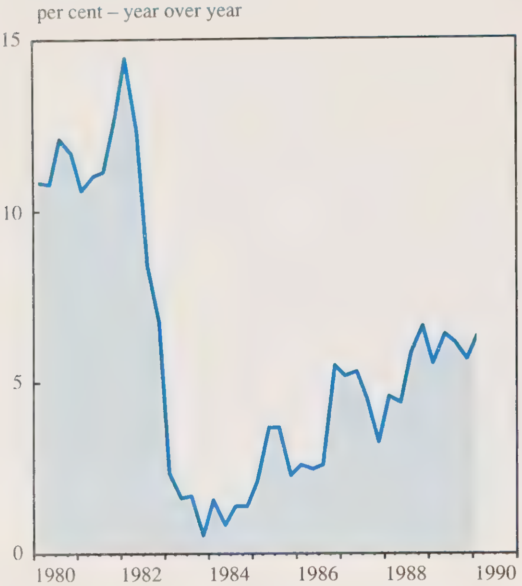
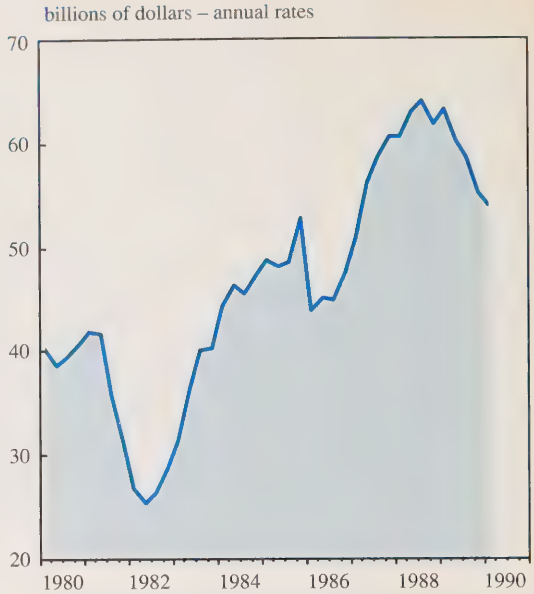


Chart 3

Profits Before Taxes



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1989			1990
		1988	1989	Q2	Q3	Q4	Q1
Real gross domestic product		4.4	3.0	1.4	3.1	2.2	2.2
Final domestic demand		5.3	3.7	2.5	– 0.3	6.5	1.6
Consumption		4.3	3.8	4.3	0.6	6.9	0.8
Residential construction		3.8	2.4	– 10.0	– 1.9	8.7	3.7
Business fixed investment		15.2	5.0	10.9	– 14.7	9.7	0.5
Non-residential construction		10.6	3.9	– 3.8	9.8	3.7	1.0
Machinery and equipment		18.4	5.7	21.2	– 27.4	13.8	0.1
Business inventory investment	(1986 $b,a.r.)	1.3	3.5	5.6	5.6	4.1	0.3
Non-farm		3.1	2.7	4.0	4.4	4.0	1.7
Trade balance	(1986 $b,a.r.)	– 5.7	– 12.8	– 16.0	– 11.4	– 15.5	– 11.7
Current account balance	(nominal)	– 10.2	– 16.7	– 18.9	– 16.8	– 18.6	– 20.3
Incomes							
Real personal disposable income		5.2	5.3	– 1.1	3.6	5.3	2.8
Profits before taxes		10.2	– 4.9	– 17.1	– 10.7	– 21.9	– 7.8
Costs and prices	(%,Y/Y)						
GDP price deflator		4.8	4.9	5.4	4.8	4.1	3.5
Consumer price index		4.0	5.0	5.0	5.3	5.2	5.4
CPI – energy component		0.6	3.5	2.6	5.4	7.1	9.6
CPI – excluding food and energy		4.8	5.5	5.5	5.8	5.5	5.2
Unit labour costs		5.4	5.9	6.4	6.1	5.7	6.4
Labour market							
Unemployment rate		7.8	7.5	7.6	7.4	7.6	7.6
Employment	(%, a.r.)	3.2	2.0	0.6	2.4	0.8	1.6
Financial markets (end of period)							
Exchange rate	(U.S.cents)	83.86	86.32	83.55	84.95	86.32	85.51
Prime interest rate		12.25	13.50	13.50	13.50	13.50	14.25

Sources: Statistics Canada and the Bank of Canada.

in labour markets translates into larger wage increases. The moderation in measured inflation reflects the appreciation of the Canadian dollar over 1989, declining profit margins, and the passing of the effects of indirect tax increases introduced last year from the calculation of year-to-year inflation rates.

Temporary Factors Slow Consumer Spending

Consumer spending registered a 0.8% (annual rate) gain in the first quarter after a 6.9% increase in the fourth quarter of 1989. The decline in growth reflected a sharp slowing in services consumption growth following an unusually large increase in the fourth quarter and a decline in consumption of heating fuels in response to moderate weather in the first quarter after unusually cold weather in December. Spending on durable and semi-durable goods continued to increase at a fairly steady pace in the first quarter. The combination of rapid growth of credit demand and high interest rates has pushed household debt-service burdens to near levels last seen in 1981. Concerns about financial positions appear evident in the decline in consumer confidence recorded by the Conference Board Survey of Consumer Attitudes in the first quarter. Retail and automobile sales data for the second quarter indicate that a slowing in consumer spending may have begun.

Housing Shows Signs of Weakening

The growth rate of residential investment fell off in the first quarter, as real estate commissions declined sharply. This was mainly a reflection of the decline in sales of existing houses. Housing sales have slowed in all regions of the country, except Atlantic Canada, with British Columbia and Ontario experiencing particularly sharp declines. New housing starts were up in the first quarter but declined in April and May. While the pace of starts in central Canada has been declining for more than a year, some slowing in Alberta and British Columbia also became apparent in May.

Investment Growth Slows Sharply

Investment spending grew at a sluggish 0.5% pace in the first quarter; spending on machinery and equipment was virtually flat while non-residential construction registered only a small gain. High interest rates, slowing demand growth, falling profits and declining rates of capacity utilization have constrained investment expenditures. Nevertheless, investment as a share of GDP remains at a very high level. The rate of inventory accumulation declined in the first quarter of 1990. While some of this decline represented the continuing recovery of wheat exports from drought-depressed levels of last year, a significant portion reflects the efforts of business to keep a tight rein on inventories in the face of slowing domestic demand growth.

Current Account Deficit Increases

Canada's merchandise trade surplus increased in the first quarter, as wheat exports rose. Despite the improvement in the merchandise trade balance, however, the current account deficit widened to $20.3 billion from $18.6 billion in the last quarter of 1989.

Cost Pressures Remain Intense

Although the CPI rate of inflation has declined in recent months, to 4.5% in May, this does not yet reflect a sustained easing in underlying cost pressures. The rate of growth in unit labour costs increased to 6.4% in the first quarter of 1990 (Chart 2). The rise in unit labour costs reflects an increase in the rate of growth of wage rates coupled with lacklustre productivity growth. Labour income per employee in the first quarter was up 7.3% over the same period last year. Labour productivity growth slowed to 0.6% in the first quarter compared to just over 1.0% in 1988 and 1989.

Profit Decline Continues

Weakening demand growth has meant that businesses have had to absorb the increasing costs and, in the case of exporters, the high external

value of the dollar in their profits. As a result, profits in the first quarter of 1990 declined for the fifth time in the last six quarters (Chart 3). In the first quarter, corporate profits stood 14.5% below their level at the same time last year. Profit margins in some industries are at their lowest levels since the early 1980s.

Unemployment Rate Edges Down in June

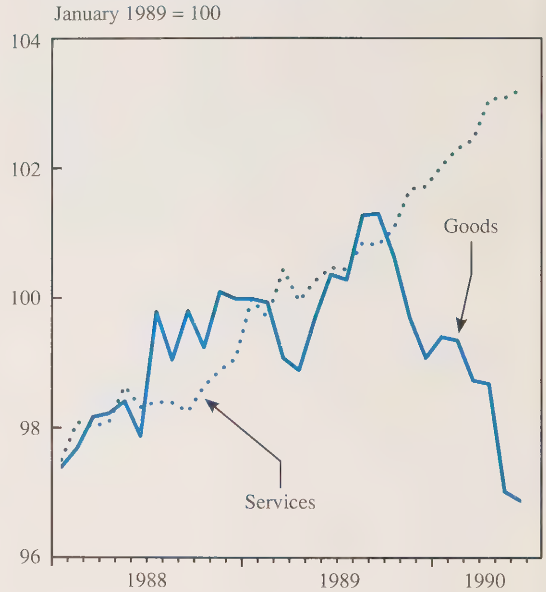
Despite weakening output growth, labour markets have remained relatively tight. The unemployment rate declined to 7.2% in both March and April. In May, the unemployment rate rose to 7.6% as employment fell 0.4%. A slight gain in employment in June caused the unemployment rate to edge down to 7.5%. Employment growth overall has clearly slowed since mid-1989. Goods-sector employment has declined 4.4% since its peak in September 1989 (Chart 4). The manufacturing sector has been particularly affected; employment in that sector is down 7.0% since its peak in February 1989.

Short-Term Interest Rates Stabilize

Financial markets have generally been stable since April. The 90-day commercial paper rate has remained around 13.75%. The Canadian dollar has traded in a range between U.S. $0.85 and $0.86 for most of the April–June period. In late June, the Canadian dollar strengthened, rising over U.S. $0.86 in early July. The growth of the money aggregates has slowed since March. Long-term interest rates have declined about 100 basis points since mid-April.

Chart 4

Indexes of Recent Employment Trends for Goods and Services



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

September 1990

Key Messages

- *Real GDP declined in the second quarter for the first time since the last quarter of 1986. All major components of final domestic demand fell. The February 1990 budget forecast predicted a slowing in growth in 1990, and noted the possibility of a negative quarter. Such a slowing in growth was viewed as essential in moderating intense underlying inflation pressures.*

- *CPI inflation continued to moderate through the summer, reaching 4.1% in August. Cost pressures, however, remain. Unit labour costs in the second quarter were up 6.6% compared with the same period in 1989. To a considerable extent the easing in inflation reflects a squeezing of profit margins to unsustainable levels.*

- *The slowing in demand growth should help to reduce underlying cost pressures and put in place the conditions for a continuation of the easing in interest rates that has been in progress since May.*

Summary

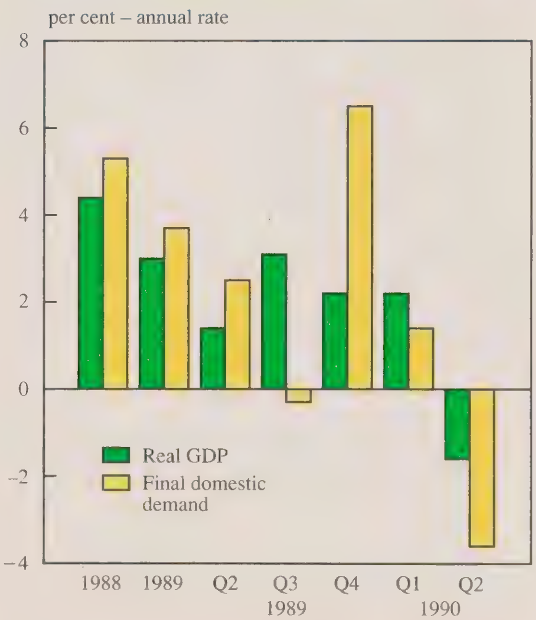
Real GDP declined in the second quarter of 1990, the first quarterly decline in real GDP since the last quarter of 1986. The drop was led by a steep and broadly based decline in final domestic demand. The decline in final domestic demand was widespread; all of the major components fell in the quarter.

Despite the decline in final domestic demand in the second quarter, inventory holdings fell as businesses continued to keep a tight rein on inventories. In addition, strong exports of energy products, machinery and equipment and motor vehicle products contributed to the liquidation of inventories. The generally lean inventory situation should moderate the current slowdown in production in the face of weakening demand and declining profits.

Price inflation, whether measured by the GDP deflator or the CPI, continued to moderate over the summer, with the CPI inflation rate declining to

Chart 1

Change in Real GDP and Final Domestic Demand



The Economy in Brief

Chart 2

Recent Growth in Inflation and Unit Labour Costs

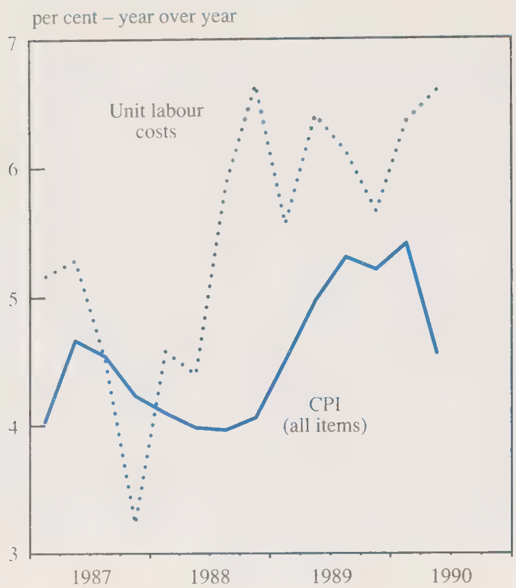
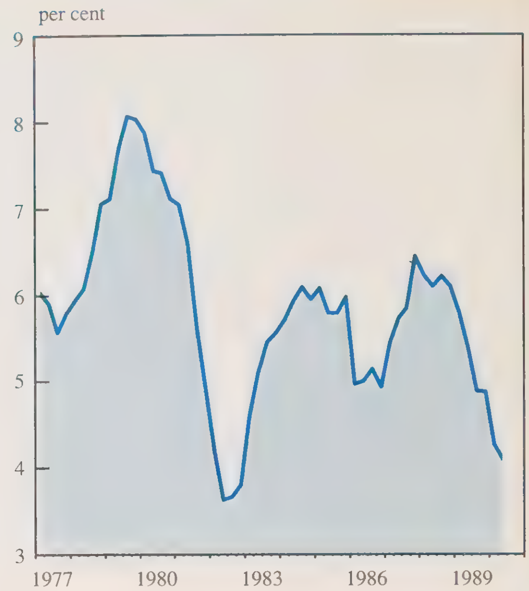


Chart 3

Industrial Corporations Profits as a Percentage of Sales



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

		1988	1989	1989 Q2	1989 Q3	1989 Q4	1990 Q1	1990 Q2
Real gross domestic product		4.4	3.0	1.4	3.1	2.2	2.1	– 1.6
Final domestic demand		5.3	3.7	2.5	– 0.3	6.5	1.4	– 3.6
Consumption		4.3	3.8	4.3	0.6	6.9	0.5	– 1.5
Residential construction		3.8	2.4	– 10.0	– 1.9	8.7	– 0.7	– 15.1
Business fixed investment		15.2	5.0	10.9	– 14.6	9.7	2.7	– 11.0
Non-residential construction		10.6	3.9	– 3.8	9.8	3.7	7.8	0.0
Machinery and equipment		18.4	5.7	21.2	– 27.4	13.8	– 0.4	– 17.9
Business inventory investment *		– 0.3	0.4	5.1	0.0	– 1.1	– 2.3	– 1.7
Non-farm *		0.0	– 0.2	4.0	0.3	– 0.3	– 1.6	– 2.1
Trade balance *		– 1.1	– 1.3	– 5.5	3.3	– 2.9	2.8	3.2
Current account balance	(nominal)	– 10.2	– 16.7	– 18.9	– 16.8	– 18.6	– 20.1	– 17.9
Real personal disposable income		5.2	5.3	– 1.1	3.6	5.3	1.9	– 5.6
Profits before taxes		10.2	– 4.9	– 17.1	– 10.7	– 21.9	– 18.7	– 29.1
Costs and prices	(%,Y/Y)							
GDP price deflator		4.8	4.9	5.4	4.8	4.1	3.6	3.1
Consumer price index		4.1	5.0	5.0	5.3	5.2	5.4	4.6
CPI – energy component		0.6	3.5	2.6	5.4	7.1	9.6	7.9
CPI – excluding food and energy		4.8	5.5	5.5	5.8	5.5	5.2	4.4
Unit labour costs		5.4	5.9	6.4	6.1	5.7	6.5	6.6
Labour market								
Unemployment rate		7.8	7.5	7.6	7.4	7.6	7.6	7.4
Employment growth	(%, a.r.)	3.2	2.0	0.6	2.4	0.8	1.6	0.8
Financial markets (end of period)								
Exchange rate	(U.S.cents)	83.86	86.32	83.55	84.95	86.32	85.51	85.96
Prime interest rate		12.25	13.50	13.50	13.50	13.50	14.00	14.75

* Change expressed as an annualized percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

4.2% in August. Cost pressures, however, continued to be strong. Unit labour costs were up 6.6% in the second quarter compared with a year earlier. To a large extent, therefore, the easing in inflation reflected continuing declines in corporate profit margins. The second quarter marked the fifth consecutive decline in corporate profits, leaving them 20% below their level of a year ago.

First Decline in Consumer Spending Since 1982

Consumer expenditure declined 1.5% in real terms in the second quarter. This was the first quarterly decline in consumer spending since the fourth quarter of 1982. All components of spending on durable and semi-durable goods fell.

The Conference Board Survey of Consumer Attitudes showed a steep decline in consumer confidence in the second quarter due to high interest rates, deteriorating personal balance sheets and less favourable employment prospects. Disposable income dipped 2.6% at an annual rate in the second quarter. This drop was caused by a large increase in direct tax payments which in part reflected changed seasonal patterns in tax collections related to the implementation of tax reform.

Residential Investment Down

Residential investment declined at a 15.1% annual rate in the second quarter, the second consecutive quarterly decline. Continuing weakness in housing sales led to a steep decline in real estate commissions. New construction also declined slightly as starts of new houses have fallen off from levels recorded at the end of last year and the beginning of this year.

Investment Declines in the Second Quarter

Spending on machinery and equipment dropped sharply in the second quarter, while non-residential construction was flat. Declines in corporate profits over the last year and a half have contributed to deteriorating balance sheets for much of the corporate sector; this now seems to be having a more noticeable effect on investment. As well, the strength of investment in the recent past and weakening sales have eased capacity constraints. Finally, business confidence has fallen in recent quarters. The second-quarter decline in investment spending stands in sharp contrast to the Statistics Canada mid-year survey of Private and Public Investment Intentions, which suggested continued strong growth in investment in 1990.

Trade Balance Improves

Exports grew strongly in the second quarter primarily due to energy products, machinery and equipment, and automotive products. The strength of exports swamped a significant gain in imports. The net export gain added 3.2 percentage points to the GDP growth rate in the second quarter. Canada's trade balance with the U.S. registered a large improvement, while the balance with the rest of the world recorded a smaller gain. The improvement in the trade balance underlay a reduction in the current account deficit from $20.1 billion in the first quarter to $17.9 billion in the second.

Unemployment Rate Up in August

With the slowing in production through 1990, employment growth has slowed. Indeed, by August employment was up only 0.3% (annualized) over the end of last year. The unemployment rate rose to 8.3% in August. Since much of the slowing in production has been in the manufacturing sector which is concentrated in Ontario, the unemployment rate has risen significantly in Ontario since the start of the year. Service sector employment continued to grow right up to August, when it registered a sharp decline.

Wage Pressures Continue

Despite the easing in labour and product markets, wage pressures have yet to abate. As a result, labour costs continue to exert pressures on prices and profit margins. In the second quarter, labour costs per unit of output in the Canadian economy were up 6.6% over the second quarter of last year. Although wage settlements appeared to moderate somewhat in the second quarter, this was mainly

due to low negotiated and imposed settlements in Quebec. Available information for the third quarter suggests that average wage settlements increased relative to the second quarter.

Price Inflation Continues to Moderate

The rate of increase in the fixed-weighted GDP deflator slowed to 3.1% in the second quarter from 3.6% in the first. The downward drift in consumer price inflation which began in March of this year continued into August. After peaking at 5.5% in January and February, the CPI inflation rate receded to 4.1% in August. To some extent, particularly between February and June, this easing reflects special factors such as the passing of the effects of harsh December weather on food and energy prices and the passing of the effects of federal and provincial indirect tax increases introduced last year from the calculation of the year-to-year inflation rates.

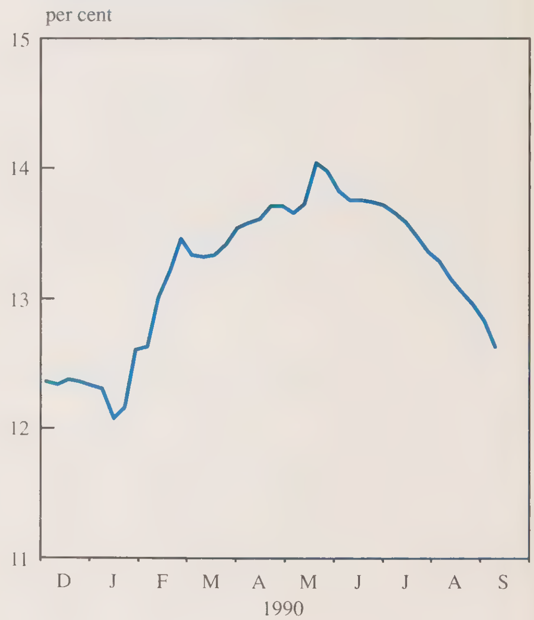
Weak demand, however, is also having a significant impact on inflation. To a large extent, the decline in inflation has come at the expense of business profit margins. Weak demand is preventing businesses from passing on cost increases in their prices. Corporate profits before taxes fell 29.1% in the second quarter of 1990. This was the fifth consecutive quarterly decline in profits and left profit margins at their lowest level since the fourth quarter of 1982.

Interest Rates Ease

Interest rates continued their gradual decline through the first half of September. Short-term interest rates declined approximately 150 basis points from their peak in late May. The differential with U.S. short-term rates has narrowed somewhat, from 565 basis points in May to approximately 450 basis points by mid-September. Despite the decline in Canadian interest rates and the reduced differential with U.S. interest rates, the Canadian dollar was quite strong over most of this period. The dollar peaked at a 12-year high of U.S. $0.8858 on August 23, but fell back to below U.S. $0.86 by September 14. The Canadian dollar, like its U.S. counterpart, fell against major overseas currencies throughout the summer.

Chart 4

Canadian 90-Day Commercial Paper Rate



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The Economy in Brief

The Quarterly Economic Review of the Department of Finance

December 1990

Key Messages

- *Real GDP in the third quarter declined for the second consecutive quarter, confirming that the Canadian economy is in recession. Available data for October and November suggest that a further decline in output is likely in the fourth quarter.*
- *The weakening in activity has allowed an easing in monetary conditions. Short-term interest rates have declined approximately 200 basis points since peaking in May.*
- *CPI inflation excluding food and energy remains in the low 4% range. To a considerable extent, this relatively favourable inflation performance reflects a severe squeeze on profit margins, as labour costs continue to increase at a rate near 6 1/2%.*

Summary

Real GDP declined 1.0% in the third quarter of 1990, following a 1.2% decline in the second quarter. The decline in output in the third quarter was augmented by strikes in the primary steel, pulp and paper, and automobile industries. On an expenditure basis, the fall in GDP was once again led by a widespread decline in domestic demand (Chart 1).

The weak demand, however, has not been accompanied by an inventory build-up. Inventory stocks have been reduced in line with sales; this should help to moderate production cutbacks in the face of continuing weak demand.

Measured CPI inflation jumped in October due to gasoline price increases. Further increases in the measured rate of inflation are expected in the coming months due to the lagged effects of higher world oil prices and the implementation of the Goods and Services Tax in January. The economic slack emerging in the economy is, however, reducing underlying price pressures, as evidenced by the declines in durable and semi-durable goods

Chart 1

Change in Real GDP and Final Domestic Demand

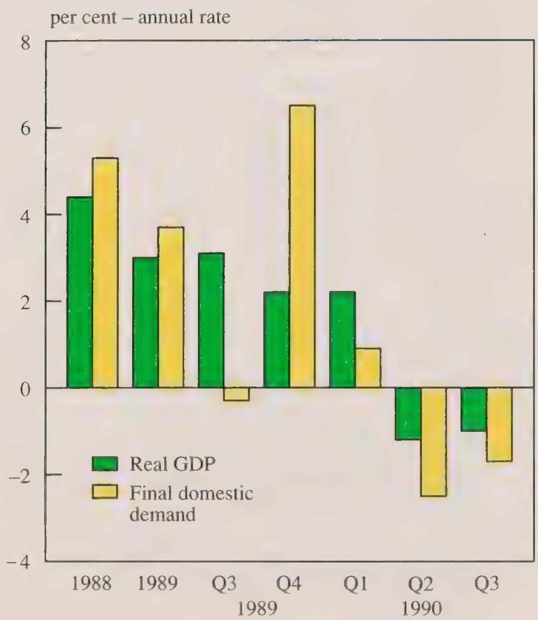


Chart 2

Corporate Profits Before Taxes

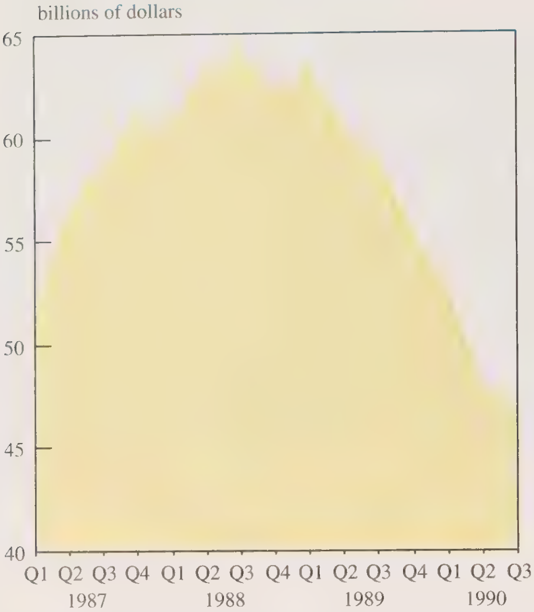
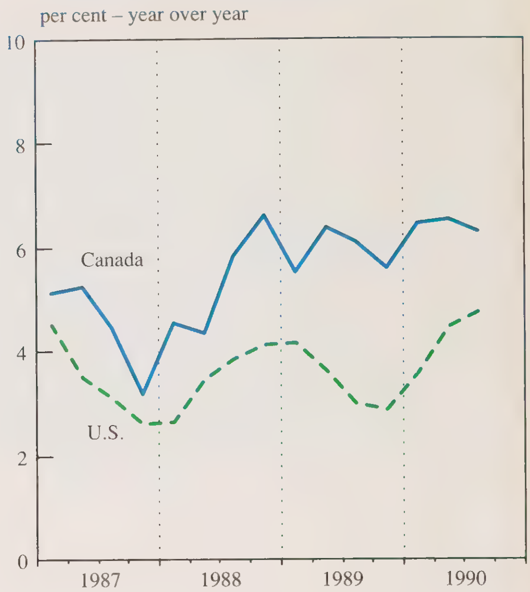


Chart 3

Growth of Unit Labour Costs Canada – U.S. Comparison



Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

				1989		1990		
		1988	1989	Q3	Q4	Q1	Q2	Q3
Real gross domestic product		4.4	3.0	3.1	2.2	2.2	– 1.2	– 1.0
Final domestic demand		5.3	3.7	– 0.3	6.5	0.9	– 2.5	– 1.7
Consumption		4.3	3.8	0.6	6.9	0.4	– 1.6	1.1
Residential construction		3.8	2.4	– 1.9	8.7	– 1.5	– 11.7	– 27.6
Business fixed investment		15.2	5.0	– 14.7	9.7	– 0.1	– 7.1	– 12.0
Non-residential construction		10.6	3.9	9.8	3.7	3.7	1.3	0.6
Machinery and equipment		18.4	5.7	– 27.4	13.8	– 2.6	– 12.5	– 20.1
Business inventory investment *		– 0.3	0.4	0.1	– 1.3	– 1.8	– 2.6	0.7
Non-farm *		0.0	– 0.2	0.3	– 0.3	– 1.8	– 2.9	– 0.2
Trade balance *		– 1.1	– 1.3	3.3	– 2.9	2.9	3.8	0.0
Exports		8.9	0.7	7.4	– 0.5	5.1	23.6	– 9.5
Imports		12.9	5.1	– 4.2	9.7	– 5.0	7.8	– 9.3
Current account balance	(nominal)	– 10.2	– 16.7	– 16.8	– 18.6	– 20.8	– 16.8	– 13.7
Real personal disposable income		5.2	5.3	3.6	5.3	2.6	– 7.4	9.9
Profits before taxes		10.2	– 4.9	– 10.7	– 21.9	– 18.0	– 33.3	– 4.1
Costs and prices	(%,Y/Y)							
GDP price deflator		4.8	4.9	4.8	4.1	3.6	3.1	2.9
Consumer price index		4.1	5.0	5.3	5.2	5.4	4.6	4.2
CPI – energy component		0.6	3.5	5.4	7.1	9.6	7.9	7.0
CPI – excluding food and energy		4.8	5.5	5.8	5.5	5.2	4.4	4.0
Unit labour costs		5.4	5.9	6.1	5.7	6.5	6.6	6.4
Labour market								
Unemployment rate		7.8	7.5	7.4	7.6	7.6	7.4	8.2
Employment growth	(%, a.r.)	3.2	2.0	2.4	0.8	1.6	0.8	– 0.7
Financial markets (end of period)								
Exchange rate	(U.S.cents)	83.86	86.32	84.95	86.32	85.51	85.96	86.60
Prime interest rate		12.25	13.50	13.50	13.50	14.00	14.75	14.25

* Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

inflation. By contrast, there has to date been little indication of an easing in wage cost pressures.

Consumer Spending Rises Slightly

Consumer spending rose 1.1% in the third quarter as spending on non-durables and some services increased. In general, however, the data for the third quarter indicate that consumers are worried about their financial positions and employment prospects. The Conference Board Survey of Consumer Attitudes for the third quarter showed confidence falling to its lowest level since the 1981-1982 recession. Spending on major items such as durable goods declined in the third quarter as households preferred to increase their savings. The more cautious attitude of households toward their financial positions was evident in the decline in the debt-income ratio in the third quarter.

Residential Investment Down Sharply

Residential investment was off 27.6% in the third quarter, the third consecutive quarterly decline. Spending on new construction led the decline. Housing starts declined from 223,000 in the first quarter of the year to 164,000 in the third quarter. New housing starts averaged 138,000 in October and November, indicating that this component of residential investment will likely weaken further in the fourth quarter. Spending on alterations and improvements in the third quarter also declined, reinforcing the picture of a household sector reluctant to undertake major new expenditures. On the other hand, sales of existing homes rebounded slightly in the third quarter, following large declines in the first half of the year.

Business Investment Down for Third Consecutive Quarter

A sharp drop in spending on machinery and equipment led to a fall in business fixed investment in the third quarter. This marked the third consecutive quarter of declining investment. Spending on non-residential construction recorded a slight increase. Weakening demand, declining capacity utilization, poor profit performance and weak balance sheets have contributed to the lacklustre performance of investment. Despite the recent declines in investment spending, investment as a share of GDP remains at a high level by historical standards.

Business Inventories Decline Again

Non-farm business inventories in the third quarter declined for a second consecutive quarter. These two declines have kept the inventory-to-sales ratio near its 1983-1989 trend level. The absence of an inventory build-up in the face of weak demand should help to moderate the current slowdown in production. Farm inventories, on the other hand, registered a sharp increase due to an above-average crop yield and weak wheat exports in the third quarter.

Current Account Improves in Third Quarter

The current account deficit narrowed to \$13.7 billion in the third quarter from \$16.8 billion in the second. Most of the improvement in the balance was due to a reduction in net dividend payments abroad from abnormally high levels in the second quarter. Declines in both merchandise imports and exports left the merchandise trade surplus little changed from the second quarter. The decline in merchandise exports was a reaction to the large increase in automotive exports to the United States in the second quarter in anticipation of a strike in Canada. Nevertheless, the level of exports has increased significantly compared to the end of last year.

Unemployment Rate Rises

The unemployment rate in Canada rose to 9.1% in November from a post-1982 recession low of 7.2% in March and April of this year. Employment losses so far in the recession have occurred largely in the goods-producing sectors of the economy.

Inflation Rate Up in October as Gasoline Prices Jump

The CPI inflation rate increased to 4.8% in October and to 5.0% in November after holding steady at 4.2% in the July-September period. Gasoline prices were up 7.3% in October and 4.1% in November, accounting for a major part of the acceleration in inflation. Excluding energy, the CPI was up 4.1% in the 12 months to November. Signs of easing inflation pressures are evident in the behaviour of some of the other components of the CPI. Prices of durable goods, for example, have actually declined over the last 12 months,

while the inflation rate in semi-durable goods has eased to 2.5%. By contrast, service prices, which are largely determined by wages, continue to rise in excess of 5 1/2%.

Profit Squeeze Continues

Corporate profits declined 4.1% in the third quarter, despite a sharp increase in the profits of oil companies. On a year-to-year basis, corporate profits were down 20.0% in the third quarter (Chart 2). While weak demand conditions are holding down prices, wage pressures persist despite the recent rise in the unemployment rate. Labour income per worker was up 6.7% year to year in the third quarter, down only slightly from the 7.0% gain registered in the second quarter. Unit labour costs continued to advance at a rate close to 6 1/2% year to year. By contrast, in the United States, unit labour costs were up approximately 4 3/4% in the third quarter (Chart 3).

Monetary Conditions Ease

Consistent with the easing in demand pressures in recent months, monetary conditions have eased. Short-term interest rates have declined by approximately 200 basis points since their peak in May (Chart 4). After an uptick in August and September in response to the uncertainty generated by the crisis in the Persian Gulf, long-term interest rates receded in October and November. By mid-December, the rate on 10-year government bonds was down more than 140 basis points from the end of September. At both the short and long ends of the spectrum, interest rates have fallen faster in Canada than in the United States Despite narrowing interest-rate differentials with the United States, the Canadian dollar traded around U.S. $0.86 from August to the beginning of December.

Chart 4

Canada 90-Day Commercial Paper Rate

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Department of Finance Canada
Ministère des Finances Canada

THE ECONOMY IN BRIEF

THE QUARTERLY ECONOMIC REVIEW OF THE DEPARTMENT OF FINANCE MARCH 1991

KEY MESSAGES

- The recession deepened in the fourth quarter of 1990 as real GDP dropped 4.0%. Domestic demand declined 1.1%.
- Interest rates continued to decline, resulting in some improvement in household financial positions and a stabilization of consumer confidence. Surveyed business investment intentions are up for 1991; these may be the first advanced signals of an improvement in the economy.
- The CPI rose over 6% in January and February, up from 5% in the last two months of 1990. Most of the increase was due to the implementation of the GST and a number of provincial sales tax changes.

SUMMARY

Real GDP declined 4.0% in the fourth quarter of 1990, the third consecutive quarterly decline (Chart 1). The level of output has now fallen 1.6% in the recession. This compares with a decline of 2.8% in the first three quarters of the 1981-1982 recession.

Real final domestic demand also declined in the fourth quarter as interest-sensitive categories of spending were cut back further. Inventories were also down sharply in the fourth quarter. Reduced demand in the United States economy led to a reduction in Canadian exports, which further detracted from growth.

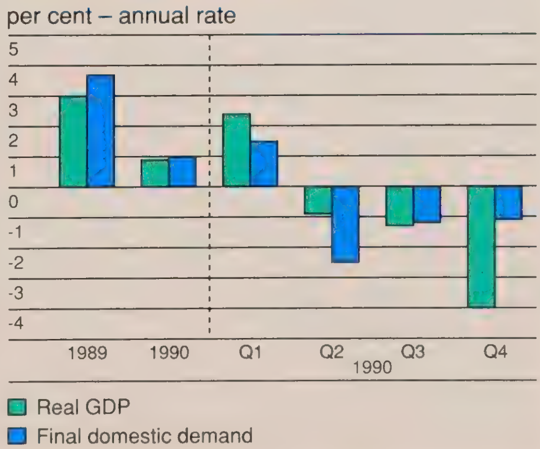
Despite the fourth-quarter decline in output, and more recent monthly data that indicate another drop is likely in the first quarter of 1991, there are some early signs that the decline in interest rates since last spring is beginning to have beneficial effects. Household financial positions and confidence have improved slightly. Business investment intentions are also up compared to last year.

CPI inflation was 6.2% in February. This was down from 6.8% in January but up from 5% in the last two months of 1990. Most of the increase was due to implementation of the GST and a number of provincial sales tax changes. Gasoline prices, which contributed to a rise in inflation late in 1990, have fallen so far in 1991.

Consumer spending down in fourth quarter

Consumer spending fell 0.8% in real terms in the fourth quarter, largely due to a decline in real disposable income. Growth in labour income,

Chart 1
Change in real GDP and final domestic demand



the largest component of disposable income, slowed as a result of employment declines. Consumer confidence, as measured by the Conference Board's Survey of Consumer Attitudes, remained at a low level in the fourth quarter. But it did turn up for the first time in over a year, reflecting a more optimistic assessment by households of their financial prospects in the light of declining interest rates (Chart 2). Household financial positions, as represented by ratios of debt to disposable income and interest payments to disposable income, also have improved slightly in recent months.

Further sharp decline in residential investment

Residential investment declined 21.9% in the fourth quarter after a 25.8% drop in the third. The decline reflected further weakness in the construction of new houses. Housing starts declined to 147,000 in the fourth quarter from 164,000 in the third. Starts declined further to 102,000 on average in January and February, the lowest level since 1982. Declines in mortgage rates and an improvement in housing affordability have led to signs of an upturn in housing markets.

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1990				
	1989	1990	Q1	Q2	Q3	Q4	Most recent
Real gross domestic product	3.0	0.9	2.4	-0.9	-1.3	-4.0	–
Final domestic demand	3.7	1.0	1.5	-2.5	-1.2	-1.1	–
Consumption	3.8	1.3	0.0	-1.7	1.0	-0.8	–
Residential construction	2.4	-6.1	2.2	-12.3	-25.8	-21.9	–
Business fixed investment	5.0	-2.3	0.7	-7.3	-9.5	-3.8	–
Non-residential construction	3.9	1.3	0.7	0.3	-2.6	-3.3	–
Machinery and equipment	5.6	-4.6	0.7	-12.1	-14.0	-4.1	–
Business inventory investment*	0.4	-0.9	-2.0	-2.3	0.2	-1.6	–
Non-farm*	-0.1	-1.0	-2.2	-2.7	-0.8	-1.5	–
Trade balance*	-1.3	0.9	3.3	3.4	-0.2	-1.2	–
Exports	0.7	3.5	7.4	20.8	-7.8	-12.8	–
Imports	5.1	0.3	-4.2	6.7	-6.9	-8.6	–
Current account balance (nominal)	-16.7	-16.0	-20.0	-16.4	-13.2	-14.5	–
Real personal disposable income	5.3	1.3	2.2	-7.4	8.9	-3.5	–
Profits before taxes	-4.9	-19.2	-20.4	-30.6	4.0	-28.5	–
Costs and prices (%,y/y)							
GDP price deflator	4.9	3.1	3.6	3.0	2.9	3.1	–
Consumer price index	5.0	4.8	5.4	4.6	4.2	4.9	6.2 (Feb.)
CPI – energy component	3.5	9.9	9.6	7.9	7.0	15.4	10.9 (Feb.)
CPI – excluding food and energy	5.5	4.4	5.2	4.4	4.0	4.1	6.0 (Feb.)
Unit labour costs	5.9	6.0	6.1	6.2	5.7	6.1	–
Labour market							
Unemployment rate	7.5	8.1	7.5	7.5	8.3	9.1	10.2 (Feb.)
Employment growth (%, a.r.)	2.0	0.7	1.4	0.2	-0.9	-2.8	-5.8 (Feb.)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.32	86.21	85.51	85.96	86.60	86.21	86.39 (Mar. 22)
Prime interest rate	13.50	12.75	14.25	14.75	13.75	12.75	11.25 (Mar. 22)

*Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Sales of existing homes in February increased 15% relative to January.

Investment spending falls in fourth quarter

Falling profit margins, declining capacity utilization rates, and weak sales led to a decline in business fixed investment in the fourth quarter, the third consecutive quarterly decline. Spending on machinery and equipment dropped 4.1%, while construction spending was down 3.3%. In 1990, investment spending in real terms was down 2.3%. The outlook for 1991 is more favourable; Statistics Canada's preliminary survey of Private and Public Investment intentions shows an increase of 5.2% in nominal investment spending in 1991, compared to a decline of 0.1% in 1990.

Non-farm inventories down sharply in fourth quarter

Investment in non-farm inventories fell $6.4 billion in real terms in the fourth quarter, subtracting 1.5 percentage points from growth in that quarter. Part of the decline, particularly at the wholesale and retail trade levels, represented an apparent desire to trim inventories prior to the implementation of the GST. Farm inventory stocks grew in the fourth quarter, reflecting above-average crop yields.

Weak demand in U.S. reflected in lower Canadian exports

A fourth-quarter decline in U.S. domestic demand was reflected in a 12.8% decline in Canadian exports. Automobile exports were down particularly sharply. Continuing weakness in domestic demand in Canada led to an 8.6% decline in imports in the fourth quarter. On a net basis, the trade sector subtracted 1.2 percentage points from the growth rate of GDP in the fourth quarter. The decline in net exports led to a worsening of the current account deficit to $14.5 billion in the fourth quarter from $13.2 billion in the third. This was still a significant improvement relative to the first-quarter deficit of $20.0 billion.

Unemployment rate continues to rise

The unemployment rate increased to 10.2% in February as employment fell 0.5%. Since March 1990, the unemployment rate has risen 3.0 percentage points. The rise in the unemployment rate is smaller than in the first 12 months of the 1981-1982 recession because

Chart 2
The Conference Board of Canada index of consumer attitudes

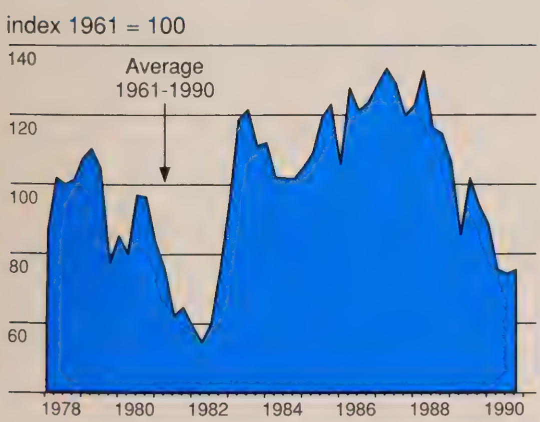
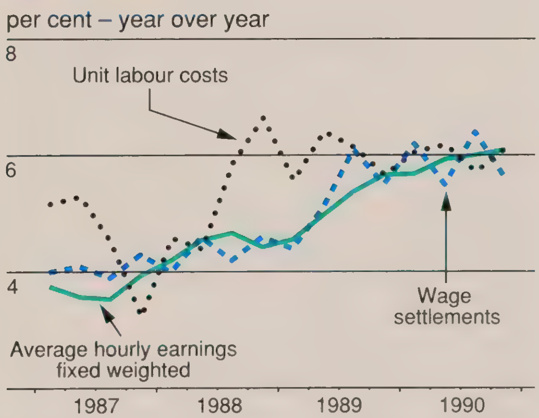


Chart 3
Wage costs



employment losses have been smaller. The cumulative loss in employment in the first 12 months of this recession is 2.6%, compared with a 4.1% loss at the same stage of the 1981-82 recession. Furthermore, fewer people have dropped out of the labour force in the present recession.

Inflation rate up as GST implemented

The 12-month increase in the CPI jumped above 6% in January and February from 5.0% in the last two months of 1990. Statistics Canada estimates that, assuming the savings from the removal of the FST were fully passed on, implementation of the GST, Quebec's harmonization of its provincial sales tax with the GST, and a number of other provincial levies raised prices 1.6%. Gasoline prices, which put upward pressure on inflation late in 1990, declined substantially in February.

Wage pressures continue in the fourth quarter

Aggregate wage measures continued to fluctuate in the 5% to 6% range in the fourth quarter of 1990 (Chart 3). Wage pressures have been especially severe in the non-commercial services sector, which includes government wages. The federal government and a number of provincial governments have announced limits on wage and salary increases for their employees.

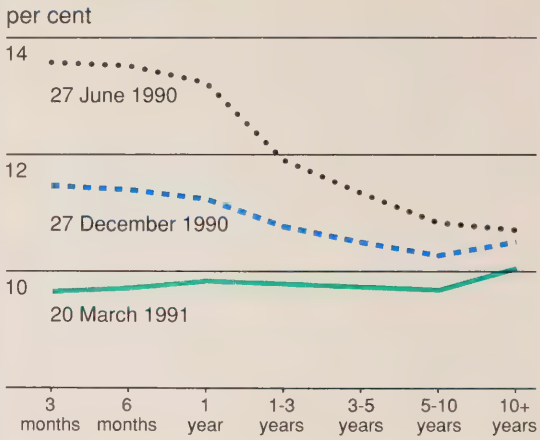
Profits fall again in fourth quarter

Weak demand and continuing high wage increases contributed to a substantial decline in corporate profits in the fourth quarter. Pre-tax corporate profits have fallen 19.9% over the past four quarters and are now 30% below their peak in the first quarter of 1989.

Decline in interest rates continues

The decline in interest rates that began in the spring of last year continued in the fourth quarter of 1990 and first quarter of 1991. As of March 22, the commercial paper rate was down 418 basis points from its peak in May 1990, and 170 basis points from the start of this year. Long-term rates have fallen as well, although not by as much as short-term rates, with the result that the yield curve, which had been inverted since September 1988, was virtually flat by late March 1991 (Chart 4). Despite a narrowing interest-rate differential with the U.S. – which is down from 565 basis points in May of 1990 to approximately 350 in late March – the Canadian dollar continued to trade in the U.S. $0.86 to U.S. $0.87 range.

Chart 4
Canadian government securities yield curve



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THE ECONOMY IN BRIEF

THE QUARTERLY ECONOMIC REVIEW OF THE DEPARTMENT OF FINANCE JUNE 1991

KEY MESSAGES

- The economy contracted 4.6% in the first quarter of 1991, bringing the cumulative loss in output since the beginning of the recession to 2.8%.
- Signs of economic recovery have increased. Lower interest rates have prompted an upturn in house purchases and construction and an increase in demand for some consumer goods such as automobiles. This led to a surge in output in April and an increase in employment in the second quarter.
- While the year-over-year rate of CPI inflation hovers above 6%, recent monthly increases have been much smaller, indicating that inflation pressures are easing.

SUMMARY

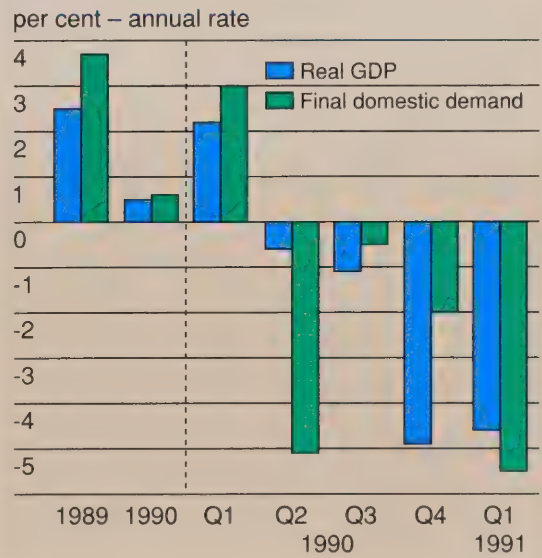
Real GDP declined 4.6% in the first quarter of 1991, the fourth consecutive quarterly decline (Chart 1). The level of output has now fallen 2.8%, compared with 3.9% after four quarters in the 1981-1982 recession.

Real final domestic demand led the decline in the first quarter, dropping 5.5% as interest-sensitive categories of spending continued to retreat. Inventories bounced back in the first quarter, largely as businesses restocked after drawing down inventories at the end of last year.

Despite the sharp decline in spending in the first quarter, there are signs in the most recent data that spending is responding to the decline in interest rates over the past 13 months. Housing sales and construction have picked up. Retail sales, led by strong sales of automobiles and furniture and appliances, increased 0.4% in April. Increases in demand led to a sharp rise in output in April, after virtually no change in February and March, as well as employment gains in the second quarter.

The year-over-year CPI inflation rate was 6.2% in May, compared with 6.3% in March and April. Over the last three months, however, consumer prices have increased at an annual rate of only 3.2%. Slack labour markets, poor business profitability and restraints on public sector wages have led to an easing in wage settlements in recent months.

Chart 1
Change in real GDP and final domestic demand



Consumer spending falls in first quarter

Consumer spending in the first quarter registered its sharpest drop of the recession, falling 7.7%. Real personal disposable income fell 8.3% in part because of a steep decline in employment. Spending on furniture, appliances, clothing, and footwear was down particularly sharply while services expenditures fell for the first time since 1982.

More recent data indicate the beginning of a recovery in consumer spending. Automobile sales were up in the second quarter. Housing sales have increased strongly in recent months (Chart 2), which have spurred the demand for household furniture and appliances.

Residential investment down in the first quarter, but signs point to a revival subsequently

Residential investment fell for the fifth consecutive quarter, as new house construction dropped sharply. Housing starts in the first quarter totalled 96,000, the lowest quarterly figure since 1957. Declining mortgage rates, however, have

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1990			1991	Most recent
	1989	1990	Q2	Q3	Q4	Q1	
Real gross domestic product	2.5	0.5	-0.6	-1.1	-4.9	-4.6	–
Final domestic demand	3.7	0.6	-5.1	-0.5	-2.0	-5.5	–
Consumption	3.2	1.3	-3.1	-1.5	-1.0	-7.7	–
Residential construction	3.5	-7.6	-19.7	-20.9	-24.8	-24.1	–
Business fixed investment	6.0	-3.2	-10.1	-11.7	-6.5	1.9	–
Non-residential construction	5.1	-2.2	-3.0	-7.1	-10.0	-2.3	–
Machinery and equipment	6.6	-3.9	-14.4	-14.6	-4.0	4.7	–
Business inventory investment*	0.1	-0.9	0.2	-0.3	-0.9	3.8	–
Non-farm*	-0.4	-1.0	-0.2	-1.1	-0.8	5.3	–
Trade balance*	-1.3	0.8	3.6	-0.2	-1.9	-0.7	–
Exports	0.6	3.8	18.1	-5.7	-15.6	-7.6	–
Imports	5.2	0.8	4.1	-5.0	-9.5	-5.1	–
Current account balance (nominal)	-20.7	-22.0	-21.7	-20.0	-21.5	-21.5	–
Real personal disposable income	4.4	1.2	-8.1	-8.8	-2.6	-8.3	–
Profits before taxes	-4.3	-24.7	-38.7	12.9	-33.9	-73.0	–
Costs and prices (%,y/y)							
GDP price deflator	4.7	3.0	2.9	2.8	2.9	3.9	–
Consumer price index	5.0	4.8	4.6	4.2	4.9	6.4	6.2 (May)
CPI – energy component	3.5	9.9	7.9	7.0	15.4	12.0	5.6 (May)
CPI – excluding food and energy	5.5	4.4	4.4	4.0	4.1	6.1	6.2 (May)
Unit labour costs	5.4	6.2	6.4	5.8	6.4	6.0	–
Labour market							
Unemployment rate	7.5	8.1	7.5	8.3	9.1	10.1	10.5 (June)
Employment growth (%, a.r.)	2.0	0.7	0.2	-0.9	-2.8	-5.7	-1.3 (June)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.32	86.21	85.96	86.60	86.21	86.38	87.16 (July 9)
Prime interest rate	13.50	12.75	14.75	13.75	12.75	11.75	9.75 (July 9)

*Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

stimulated increased activity in housing. Sales of existing houses have increased for four consecutive months, and in May were 69% above the level of a year ago. New housing starts have also responded, reaching 162,000 units in June.

GST spurs investment spending

The replacement in January of the federal sales tax (FST) by the GST significantly lowered the price of many capital goods, leading many businesses to delay purchases of machinery and equipment until the first quarter of this year. As a result, spending on machinery and equipment was up 4.7% in the first quarter. Low profit levels, poor sales and low capacity utilization rates continued to make for a weak underlying investment performance. This was reflected in the 2.3% decline in non-residential investment.

Businesses restock

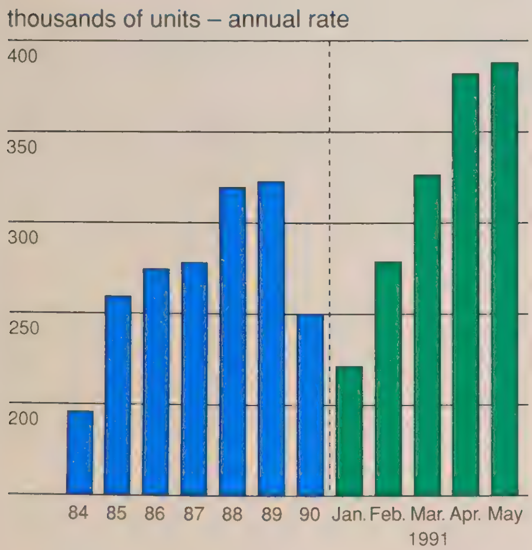
Businesses ran down inventories at the end of last year. In the first quarter inventories, particularly at the wholesale level, were rebuilt. The upswing in non-farm inventories added 5.3 percentage points to the growth of GDP in the first quarter. Even with the first-quarter surge in inventory investment, however, the inventory-to-sales ratio remains roughly in line with its trend since 1983, indicating that a resumption in demand growth will quickly prompt increased production.

Current account balance unchanged

Weak first-quarter demand in Canada led to a decline in imports. At the same time, however, the recession in the U.S. economy reduced the demand for Canadian exports, particularly of automotive products, even more. As a result, Canada's trade balance deteriorated in the first quarter.

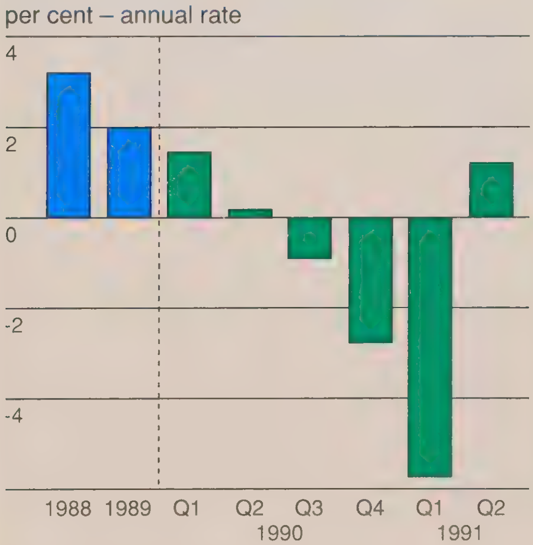
The current account deficit was unchanged from the fourth quarter of last year at $21.5 billion, as the deterioration in the trade balance was offset by an improvement in the investment income and transfers balances. A change in the way Statistics Canada calculates inheritances and migrants' funds has led to significant revisions to Canada's current account deficit. The deficit for 1990 is now $22.0 billion, compared with the previous estimate of $16.0 billion.

Chart 2
Sales of existing houses in Canada[1]



[1]Multiple Listing Service data are seasonally adjusted by the Department of Finance.

Chart 3
Quarterly employment growth



Employment gains in second quarter

Employment was up 1.2% in the second quarter (Chart 3). Ontario and Quebec, which had been hardest hit by the recession, saw gains in employment in the quarter. Labour force growth, however, also picked up in the second quarter. As a result, the unemployment rate in June was 10.5%, the same as in March.

Inflation pressures ease

The year-over-year inflation rate in May was 6.2%, more or less unchanged since February. Monthly increases in the CPI in recent months have generally been moderate. The annualized rate of inflation in the last three months, for example, has been 3.2%. This moderation has occurred despite some federal and provincial indirect tax increases. Wage settlements appear to have peaked. Private sector settlements have been declining since the third quarter of last year. Public sector settlements in April provided wage increases averaging 3.4%, largely due to the introduction of public service wage guidelines. The federal government and seven provincial governments have introduced public sector wage restraints.

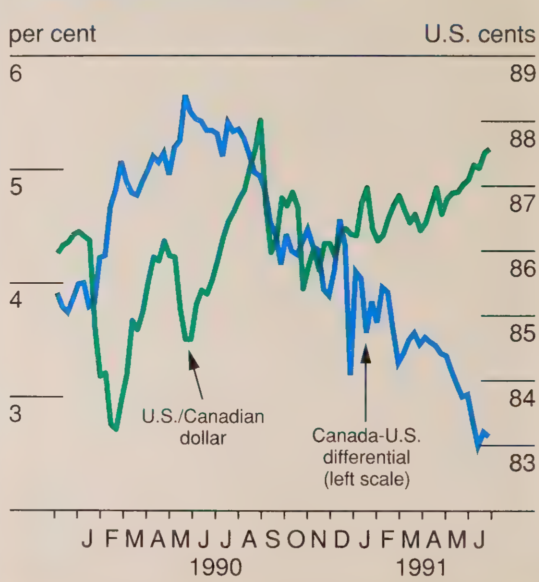
Profits drop further in first quarter

Corporate profits fell at a quarterly rate of 27.9% in the first quarter, the largest one-quarter decline in the recession. In the climate of weak demand, businesses have been unable to pass on increases in unit labour costs, which continued at a year-over-year rate of 6% in the first quarter. Since their peak in the first quarter of 1989, corporate profits have fallen 55.7%.

Dollar strengthens despite interest-rate declines

Although short-term interest rates have fallen almost 530 basis points since their peak in May 1990, and the differential with U.S. short-term rates has been more than halved, the Canadian dollar has strengthened in recent months (Chart 4). In February the Canadian dollar rose above U.S. $0.86, and since May has been trading above U.S. $0.87.

Chart 4
Foreign price of the Canadian dollar and Canada-U.S. interest rate differential



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THE ECONOMY IN BRIEF

THE QUARTERLY ECONOMIC REVIEW OF THE DEPARTMENT OF FINANCE SEPTEMBER 1991

MAIN MESSAGES

- The economy began to recover in the second quarter, growing a robust 4.9% after four consecutive quarters of decline.
- The unemployment rate has flattened out at about 10½%. Employment typically recovers more slowly than output as businesses initially respond to the increase in demand by using labour more intensively.
- Since January, month-to-month increases in the CPI have generally been small. Private-sector wage settlements and settlements in government jurisdictions with wage guidelines have also eased.

SUMMARY

The economy grew 4.9% in the second quarter, the first increase after four consecutive quarters of decline (Chart 1). The strong gain in output in the second quarter made up over 40% of the output lost during the recession.

Residential investment and consumer durables expenditure, which are sensitive to lower interest rates, were the leading components of domestic demand. Exports rose strongly, largely due to increased automobile sales to the United States.

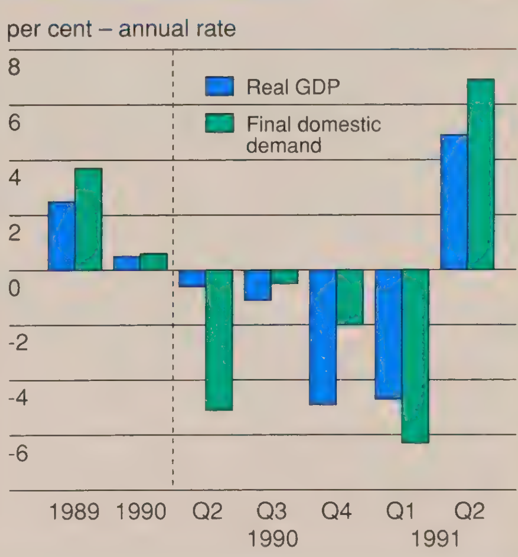
The total demand for Canadian goods and services (GDP less the change in inventories) grew 9.1% in the second quarter. Almost half of this increase in demand was satisfied by a negative swing in inventories.

The 12-month CPI inflation rate eased to 5.8% in July and August. The 12-month rate, however, is heavily influenced by the introduction of the GST in January. Month-to-month increases in the CPI since January have averaged 2.5% at an annual rate. Wage settlements have also eased in recent months. This is especially evident in those public sector jurisdictions where wage-restraint programs are in effect.

Consumer spending rebounds in second quarter

Consumer spending was up 7.8% in the second quarter, virtually offsetting the 7.9% drop in the first quarter. Spending on durable goods led the advance, increasing 28.5%. Car sales increased strongly as did sales of household furnishings and appliances.

Chart 1
Change in real GDP and final domestic demand



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Canada

The increase in consumer spending reflected a solid increase in both real personal disposable income and a decline in the personal savings rate. As well, lower interest rates and increased employment prospects buoyed consumer confidence. The Conference Board's Index of Consumer Attitudes increased 17.3% in the second quarter.

Residential investment up strongly in second quarter

Lower interest rates prompted a 21.3% increase in residential investment in the second quarter, after five consecutive quarters of decline. A large increase in real estate commissions accounted for nearly all of the rise, reflecting strong sales of existing houses since the start of the year. In April, these sales achieved a record level and have remained high.

New construction was up only slightly in the second quarter. Housing starts increased sharply, but since a house takes several months to build, the rise had only a small effect on second-quarter construction investment. Starts continued to increase in the third quarter; in July and August, they averaged 174,000, up from 152,000 in the second quarter and 96,000 in the first.

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1990		1991		Most recent
	1989	1990	Q3	Q4	Q1	Q2	
Real gross domestic product	2.5	0.5	-1.1	-4.9	-4.7	4.9	–
Final domestic demand	3.7	0.6	-0.5	-2.0	-6.3	6.9	–
Consumption	3.2	1.3	1.5	-1.0	-7.9	7.8	–
Residential construction	3.5	-7.6	-20.9	-24.8	-22.5	21.3	–
Business fixed investment	6.0	-3.2	-11.7	-6.5	1.1	0.8	–
Non-residential construction	5.1	-2.2	-7.1	-10.0	-4.5	-2.1	–
Machinery and equipment	6.6	-3.9	-14.6	-4.0	4.9	2.7	–
Business inventory investment[1]	0.1	-0.9	-0.3	-0.9	3.7	-3.9	–
Non-farm[1]	-0.4	-1.0	-1.1	-0.8	4.9	-3.3	–
Trade balance[1]	-1.3	0.8	-0.2	-1.9	0.0	2.2	–
Exports	0.6	3.8	-5.7	-15.6	-5.2	22.2	–
Imports	5.2	0.8	-5.0	-9.5	-4.9	12.6	–
Current account balance (nominal)	-20.7	-22.0	-20.0	-21.5	-22.1	-22.1	–
Real personal disposable income	4.4	1.2	8.8	-2.6	-6.0	3.6	–
Profits before taxes	-4.3	-24.7	12.9	-33.9	-73.7	40.0	–
Costs and prices (%,y/y)							
GDP price deflator	4.7	3.0	2.8	2.9	3.6	3.4	–
Consumer price index	5.0	4.8	4.2	4.9	6.4	6.3	5.8 (August)
CPI – excluding food and energy	5.5	4.4	4.1	4.1	6.1	6.3	5.9 (August)
Unit labour costs	5.4	6.2	5.8	6.4	6.8	4.9	–
Labour market							
Unemployment rate	7.5	8.1	8.3	9.1	10.1	10.3	10.6 (August)
Employment growth (%, a.r.)	2.0	0.7	-0.9	-2.8	-5.7	1.3	-1.9 (August)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.32	86.21	86.60	86.21	86.38	87.59	88.14 (Sept. 25)
Prime interest rate	13.50	12.75	13.75	12.75	11.25	9.75	9.50 (Sept. 25)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Business investment still sluggish

Business fixed investment increased 0.8% in the second quarter, as non-residential construction fell for the fifth consecutive quarter. Investment typically recovers later than output; businesses increase the rate of utilization of existing capital before investing in new facilities.

Weak corporate financial positions also contributed to the sluggishness of investment. While profits increased, they are still 50% below their peak in the first quarter of 1989.

Inventories down in second quarter

Businesses satisfied part of the increase in demand in the second quarter by drawing down inventories. Without the negative swing in inventories, real GDP would have grown 9.1% in the second quarter.

The decline in inventories was particularly marked in the manufacturing sector, where inventories fell for the sixth consecutive quarter. Farm inventories also declined due to strong wheat exports.

Inventories are generally lean. Increases in demand, therefore, will likely be quickly reflected in increased production.

Chart 2
CPI Inflation rate

Exports and imports show strong growth

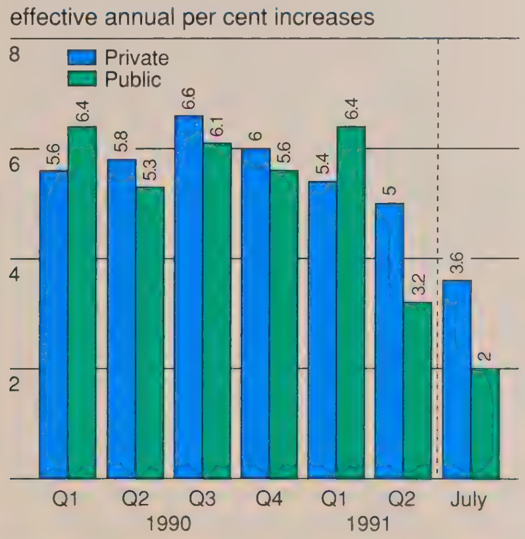
Exports increased 22.2% in the second quarter. Automotive exports to the United States accounted for almost two-thirds of the increase. Imports were up 12.6%, largely due to stronger domestic demand.

While the merchandise trade balance improved slightly, the investment income balance deteriorated further. The current account deficit was $22.1 billion, unchanged from the first quarter.

Unemployment rate up slightly

After a strong increase in the second quarter, employment stabilized in July and August. The unemployment rate rose slightly to 10.6 per cent in August. Slow growth in employment is not unusual in the early stages of economic recoveries. Businesses prefer to meet an increase in demand initially by using labour more intensively and raising productivity. Employment begins to increase more substantially when companies are convinced that a lasting recovery is under way.

Chart 3
Private and public-sector wage settlements



Inflation pressures ease further

The 12-month inflation rate was 5.8% in July and August, down from 6.3% in June. The 12-month inflation rate, however, is heavily influenced by the introduction of the GST in January. Inflation measures that focus on recent developments show much lower rates. For example, the annualized rate of inflation in the three months to August was 3.2% (Chart 2). The GDP deflator, a broader measure of inflation, increased 3.4% in the year ending with the second quarter of 1991.

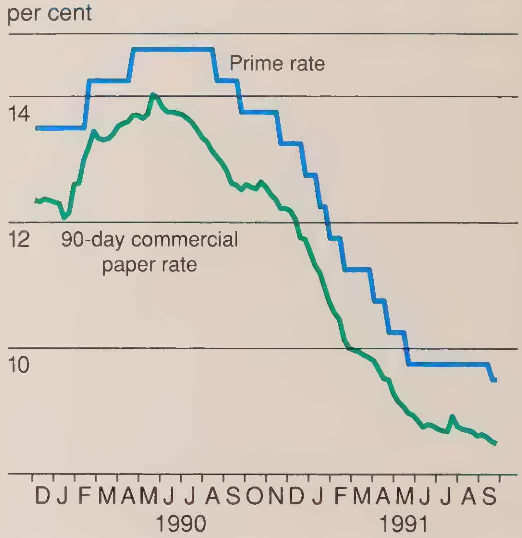
During the recession, reductions in the inflation rate came largely at the expense of profit margins, as businesses were unable to pass on increased costs, such as wages. More recently, however, wage pressures have also begun to ease (Chart 3). Private-sector settlements in July averaged 3.6%, the smallest monthly increase since November 1987. Public-sector settlements, especially in those jurisdictions with wage-restraint programs, have been even lower.

Interest rates decline modestly

Canadian interest rates have continued to decline, albeit modestly since June 1991 (Chart 4). The steady declines allowed Canadian banks to lower their prime lending rate on September 12 to 9.50% from 9.75%. One major bank further reduced its prime rate to 9.25% on September 20. The Canadian dollar has strengthened since July, and in mid-September fluctuated around U.S. $0.88. Both currencies have fallen against major overseas currencies since July.

Long-term interest rates have moved down by about three-quarters of a percentage point since the end of June, reflecting strong demand for long-term securities and lower inflation expectations.

Chart 4
Prime rate and Canada 90-day commercial paper rate



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THE ECONOMY IN BRIEF

THE QUARTERLY ECONOMIC REVIEW OF THE DEPARTMENT OF FINANCE DECEMBER 1991

KEY MESSAGES

- The recovery that began in the second quarter continued in the third, but at a modest pace of under 1% growth. Over the second and third quarters, real growth averaged 3.3%.
- Inflation performance continues to improve. The 12-month rate of inflation dropped to 4.2% in November. In the last six months, prices have risen at an annualized rate of 1.9%.
- In response to the improving inflation performance, interest rates continue to fall. The prime lending rate is now at an 18-year low.

SUMMARY

Real GDP increased 0.9% in the third quarter, after a strong 5.7% increase in the second (Chart 1). Final domestic demand growth slowed to 1.6% from 7.5% in the previous quarter.

The third-quarter drop in growth was due mainly to a sharp slowing in consumer spending and a decline in business investment. Residential investment and exports registered large gains for the second consecutive quarter. Despite slow growth of demand in Canada, imports surged.

Price and wage inflation continued to slow. Over the last six months, prices have risen at an annualized rate of 1.9%, a rate comparable to the early 1970s.

In response to easing inflation pressures, interest rates continued to fall. The chartered banks' prime lending rate, for example, was lowered five times in the fourth quarter, to 8.0% in early December, its lowest rate in 18 years.

Consumer spending slows sharply

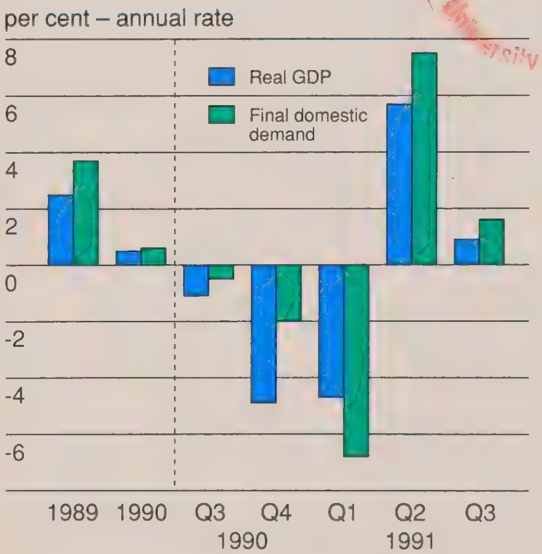
After a gain of 8.0% in the second quarter, consumer spending increased 0.8% in the third. All major categories of spending slowed.

A small decline in real personal disposable income in the third quarter contributed to the slowdown in spending. In addition, household confidence remains low.

Housing continues to strengthen

Residential investment increased 17.2% in the third quarter, after a gain of 32.7% in the second quarter. Most of the third-quarter increase was in new construction, as opposed to the previous

Chart 1
Change in real GDP and final domestic demand



quarter when real estate commissions were the leading category.

Sales of existing houses picked up early in the year in response to declining mortgage rates. A revival in construction followed. Housing starts increased from 96,000 in the first quarter to 152,000 in the second and 181,000 in the third. Thus far in the fourth quarter, starts have averaged 191,000.

Investment declines for second consecutive quarter

Business investment declined 4.2% in the third quarter, the second consecutive quarterly decline and fifth in the last six quarters. Investment continues to be hindered by low rates of capacity utilization, poor corporate profit margins and low levels of business confidence.

Inventory investment fell again in the third quarter, the sixth decumulation in the last seven quarters. This decumulation, however, was much smaller than in the second quarter. As a result, the positive swing in inventories added 2.6 percentage points to growth in the third quarter.

Import surge leads to record current account deficit

Canada's current account deficit deteriorated to a record $28.8 billion in the third quarter, mainly

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1990	1991			
	1989	1990	Q4	Q1	Q2	Q3	Most recent
Real gross domestic product	2.5	0.5	-4.9	-4.7	5.7	0.9	–
Final domestic demand	3.7	0.6	-2.0	-6.8	7.5	1.6	–
Consumption	3.2	1.3	-1.0	-8.5	8.0	0.8	–
Residential construction	3.5	-7.6	-24.8	-26.2	32.7	17.2	–
Business fixed investment	6.0	-3.2	-6.5	1.5	-1.6	-4.2	–
Non-residential construction	5.1	-2.2	-10.0	-4.1	-4.7	-6.9	–
Machinery and equipment	6.6	-3.9	-4.0	5.4	0.5	-2.4	–
Business inventory investment[1]	0.1	-0.9	-0.9	3.7	-4.0	2.6	–
Non-farm[1]	-0.4	-1.0	-0.8	4.6	-3.3	2.4	–
Trade balance[1]	-1.3	0.8	-1.9	0.4	2.4	-4.2	–
Exports	0.6	3.8	-15.6	-4.0	22.5	10.4	–
Imports	5.2	0.8	-9.5	-5.1	12.5	26.0	–
Current account balance (nominal)	-20.7	-22.0	-21.5	-22.0	-21.9	-28.8	–
Real personal disposable income	4.4	1.2	-2.6	-6.2	7.1	-0.4	–
Profits before taxes	-4.3	-24.7	-33.9	-73.0	39.4	15.1	–
Costs and prices (%,y/y)							
GDP price deflator	4.7	3.0	2.9	3.5	3.4	2.7	–
Consumer price index	5.0	4.8	4.9	6.4	6.3	5.7	4.2 (Nov.)
CPI – excluding food and energy	5.5	4.4	4.1	6.1	6.3	5.8	5.2 (Nov.)
Unit labour costs	5.4	6.2	6.4	6.7	4.9	5.0	
Labour market							
Unemployment rate	7.5	8.1	9.1	10.1	10.3	10.4	10.3 (Nov.)
Employment growth (%, a.r.)	2.0	0.7	-2.8	-5.7	1.2	0.2	-4.6 (Nov.)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.32	86.21	86.21	86.38	87.59	88.33	86.51 (Dec.20)
Prime interest rate	13.50	12.75	12.75	11.25	9.75	9.50	8.00 (Dec.20)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

due to a sharp deterioration in Canada's merchandise trade surplus. Canada's real merchandise exports were up 12.4% in the third quarter. Growth would likely have been even stronger had the U.S. economy not been so weak. The volume of merchandise imports surged 30.6%, as imports of automotive products increased sharply. A further deterioration in Canada's terms of trade also contributed to the deterioration in the merchandise trade surplus.

Unemployment slow to fall

Despite modest gains in employment since the recovery began, the unemployment rate has been slow to fall. In November, the unemployment rate was 10.3%, unchanged from October and down only slightly from its most recent peak of 10.6% in August. Employment is up 52,000 since its trough in February 1991. The labour force, however, has increased 77,000 over this period.

An indicator of some improvement in labour market conditions are the recent gains in full-time employment – up 96,000 since August.

Inflation down dramatically

The 12-month inflation rate fell to 4.2% in October from rates of over 5% as recently as September (Chart 2). The 12-month rate, however, is affected by the one-time jump in the price level associated with the introduction of the GST in January and thus masks the dramatic improvement in inflation this year. Month-to-month increases in the CPI have averaged 1.9% at an annual rate over the last six months and only 0.6% over the last three months.

Wage inflation continues to ease

Wage increases provided in major collective agreements declined to just over 3% in the second and third quarters and to 2% in October. Private-sector settlements provided wage increases of 4.2% in the third quarter and 2.4% in October, down from a peak of 6.5% in the third quarter of last year.

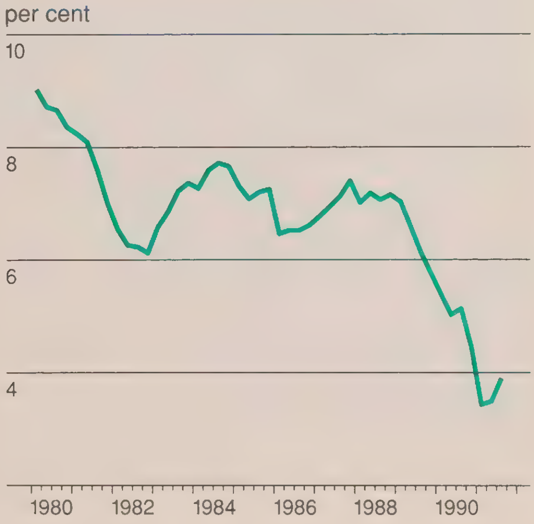
Public-sector settlements eased to 2.8% in the third quarter reflecting the influence of public-sector wage-restraint programs by the federal and most provincial governments.

Profits up for second consecutive quarter

Corporate profits increased 15.1% in the third quarter after a 39.4% advance in the second. Even with these two gains, however, corporate profits

Chart 2
CPI Inflation rate – all items

Chart 3
Profit margins of non-financial corporations



remain almost 50% below their peak level attained in the first quarter of 1989. Profit margins have also improved in the last two quarters, but remain near record lows (Chart 3). The weak financial position of corporations is contributing to weak investment performance.

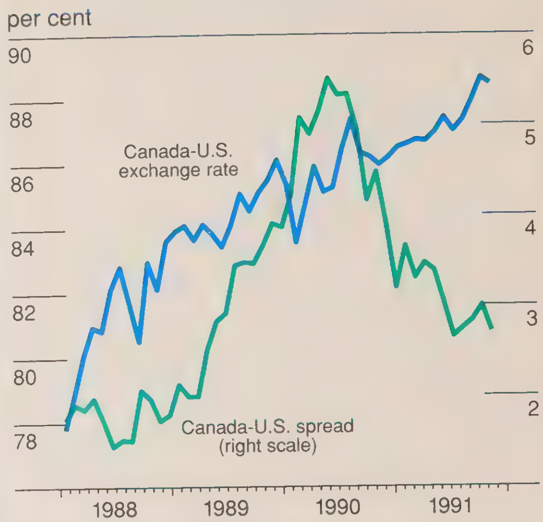
Interest rates fall further

The 90-day commercial paper rate has fallen 85 basis points since the end of September. It has dropped over 650 basis points from its peak in May 1990. The chartered banks' prime lending rate in early December fell to an 18-year low of 8.0%.

Canadian short-term rates have fallen faster than their U.S. counterparts. The differential between Canadian and American 90-day paper rates declined throughout the year, and now stands at about 280 basis points (Chart 4).

The Canadian dollar continued to strengthen against its U.S. counterpart until the first week of November, when it hit a peak of U.S. $0.8929. It has since fallen to about U.S. $0.865.

Chart 4
Canada-U.S. exchange rate versus interest rate spread



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THE ECONOMY IN BRIEF

THE QUARTERLY ECONOMIC REVIEW OF THE DEPARTMENT OF FINANCE · MARCH 1992

MAIN MESSAGES

- Real GDP declined in the fourth quarter. A drop in exports due to weakness in the U.S. economy was the main reason for this decline.
- Canada's CPI inflation rate fell to 1.6% in January, the lowest rate since the early 1970s.
- Canada's cost performance also continued to improve. Unit labour costs in the fourth quarter were up only 2.4% from the year before. This is rate of increase since the end of 1985.
- The Canadian dollar has fallen sharply since its peak in November. In response to recent volatility in foreign exchange markets, short-term interest rates have increased.

SUMMARY

Real GDP fell 0.8% in the fourth quarter of 1991 after two consecutive quarterly increases. The major factor in the decline was an 11.3% drop in exports. Domestic demand (GDP less net exports) increased 0.9% (Chart 1). For 1991 as a whole, real GDP fell 1.5% after a 0.5% increase in 1990.

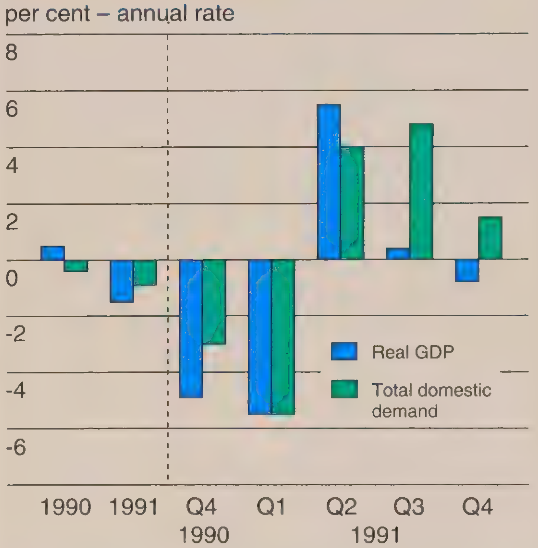
The 12-month CPI inflation rate fell to 1.6% in January as the one-time effect of the introduction of the GST last January on the price level dropped out of the calculation.

The decline in the value of the Canadian dollar against its U.S. counterpart that began in November last year continued through early March. The dollar is down over 5½ U.S. cents from its November peak. Short-term interest rates have risen somewhat from the lows recorded in January in response to recent volatility in foreign exchange markets.

Consumer spending falls in fourth quarter

Consumer spending dropped 1.6% in the fourth quarter of 1991 after a 0.8% decline in the third. This reflects in part a low level of consumer confidence. This was particularly evident in the sharp declines in categories of expenditures that are generally considered discretionary or non-essential. Spending on consumer durables fell 16.3%, with auto purchases being especially weak. Spending on hotels and restaurants was also down.

Chart 1
Change in real GDP and total domestic demand



Housing investment leads domestic demand

Residential investment increased 6.0% in the fourth quarter on the strength of construction of new houses. Starts of new houses increased considerably in the second half of the year and this was reflected in construction expenditures. Spending on alterations and improvements and real estate commissions both declined in the fourth quarter.

Two measures were announced in early 1992 that will stimulate housing activity in coming months. The minimum downpayment for NHA-insured mortgages was lowered from 10% to 5%. As well, until March 1993, households will be able to use existing RRSP funds to purchase a house.

Business investment continues to rise

Business fixed investment increased 5.7% in the fourth quarter as spending on machinery and equipment jumped 20.7%. Non-residential construction fell 14.0% in the fourth quarter. High vacancy rates in the commercial real estate sector are discouraging new construction.

The February 1992 budget announced a lowering of the manufacturing and processing tax rate as

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1991				Most
	1990	1991	Q1	Q2	Q3	Q4	recent
Real gross domestic product	0.5	-1.5	-5.5	5.5	0.4	-0.8	–
Final domestic demand	0.6	-0.9	-6.6	7.6	1.3	0.3	–
Consumption	1.3	-1.1	-7.7	7.4	-0.8	-1.6	–
Residential construction	-7.6	-8.5	-27.8	42.6	17.3	6.0	–
Business fixed investment	-3.2	-1.9	2.6	1.0	3.4	5.7	–
Non-residential construction	-2.2	-3.1	1.7	2.2	0.9	-14.0	–
Machinery and equipment	-3.9	-1.1	3.3	0.2	5.0	20.4	–
Business inventory investment[1]	-0.9	0.4	3.0	-3.2	3.3	0.6	–
Non-farm[1]	-1.0	0.6	4.0	-2.5	2.8	0.6	–
Trade balance[1]	0.8	-0.6	0.0	1.4	-4.3	-2.3	–
Exports	3.8	0.6	-4.3	21.9	13.2	-11.3	–
Imports	0.8	2.5	-4.2	15.4	29.4	-3.7	–
Current account balance (nominal)	-22.0	-26.8	-22.1	-22.9	-29.9	-32.2	–
Real personal disposable income	1.2	-1.5	-6.8	5.4	-3.5	-5.0	–
Profits before taxes	-24.7	-32.3	-73.4	45.9	-1.0	-43.3	–
Costs and prices (%,y/y)							
GDP price deflator	3.0	2.7	4.1	2.1	-0.2	1.5	–
Consumer price index	4.8	5.6	6.4	6.3	5.7	4.1	1.6 (Jan.)
CPI – energy component	9.9	4.9	12.0	5.0	6.5	-3.1	6.0 (Jan.)
CPI – excluding food and energy	4.4	5.9	6.1	6.3	5.8	5.1	2.9 (Jan.)
Unit labour costs	6.2	4.1	6.3	-1.8	2.3	3.0	
Labour market							
Unemployment rate	8.1	10.3	10.2	10.3	10.4	10.3	10.4 (Jan.)
Employment growth (%, a.r.)	0.7	-1.8	-4.7	0.9	0.1	-0.3	-1.3 (Jan.)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.21	86.54	86.38	87.59	88.33	86.54	83.68 (Mar. 11)
Prime interest rate	12.75	8.00	11.25	9.75	9.50	8.00	8.25 (Mar. 11)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

well as an increase in the capital cost allowance rate. These measures should help to stimulate investment.

Inventories rise

Inventories increased $1.8 billion in the fourth quarter, adding 0.6 percentage point to the growth rate of GDP. About three-quarters of this increase was in non-farm inventories. The increase in non-farm inventories occurred mainly at the retail and wholesale levels, as weak Christmas sales left merchants with larger-than-expected stocks.

Exports down as U.S. economy weakened

Total exports fell 11.3%, largely due to a 34.5% decline in automobile exports. Weakness in the U.S. economy was a major factor in the decline in Canadian exports. Canadian imports fell 3.7% in the fourth quarter.

Current account deficit up

The current account deficit was $32.2 billion in the fourth quarter, compared with $29.9 billion in the third. For the year 1991, the current account deficit totalled $26.8 billion, up from $22.0 billion in 1990.

The deterioration in the current account deficit in 1991 resulted largely from a decline in the merchandise trade surplus. Canada's deficit in service transactions also increased due to increased travel payments by Canadians. The deficit on net investment income payments fell slightly.

Employment down

Employment fell 0.1% in February, sending the unemployment rate to 10.6% from 10.4% in January. Employment has been falling since May reflecting the sluggish growth in output since the second quarter. In addition, the restructuring of Canadian industry to meet increased global competition has contributed to labour market dislocation. Recent job losses have been concentrated in blue-collar occupations and among workers with low levels of education.

Inflation rate drops sharply in January

Canada's inflation performance has improved steadily over the past year (Chart 2). In January, the 12-month rate of CPI inflation dropped to 1.6% from 3.8% in December. The January rate is the lowest in over 20 years. Canada now has the lowest rate of inflation in the G-7.

Chart 2
CPI inflation rate

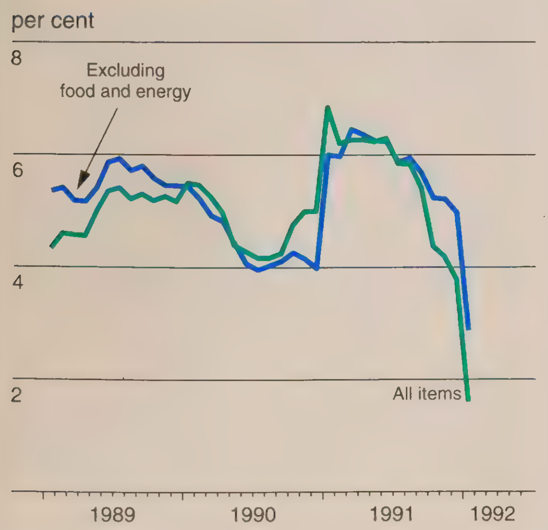
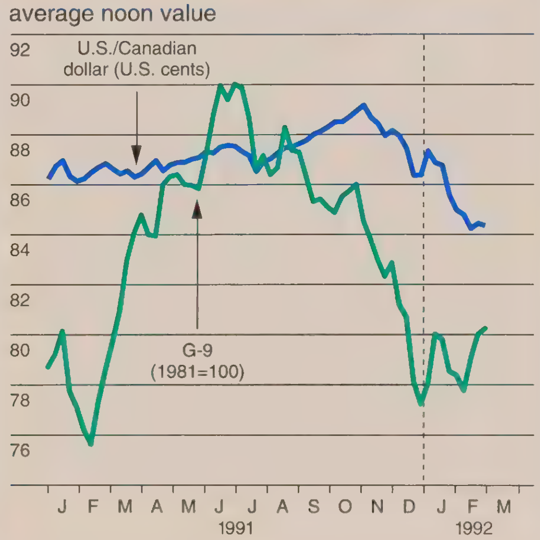


Chart 3
Foreign price of the Canadian dollar



Wage pressures continue to ease

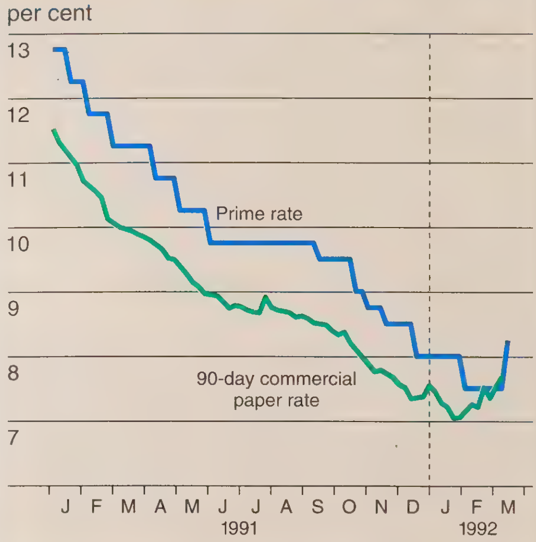
Recent wage settlements reflect the weakness in the labour market and the lower rate of price inflation. Wage increases provided in major contract settlements fell to 2.5% in the fourth quarter from 6.1% in the first quarter of the year. Private-sector settlements averaged 3.3% in the fourth quarter, continuing the downward trend since the third quarter of 1990. Public-sector settlements averaged 2.4% in the fourth quarter, reflecting the wage-restraint programs put in place by the federal and most provincial governments.

Canadian dollar off sharply against U.S. counterpart

The Canadian dollar peaked against its U.S. counterpart at U.S. $0.8929 in early November 1991 (Chart 3). Since then the dollar has fallen to below U.S. $0.84, its lowest point since February 1990. Recent volatility in foreign exchange markets has led to some upward pressure on interest rates. The commercial paper rate has risen roughly 75 basis points from its recent low of 7.00% in late January. In early March, most Canadian banks raised their prime lending rate 75 basis points to 8.25% (Chart 4).

To some extent, the decline in the value of the Canadian dollar in 1992 reflects strength of the U.S. dollar. Since the start of this year, the Canadian currency has been more or less stable against major overseas currencies.

Chart 4
Prime rate and 90-day commercial paper rate, Canada



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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE JULY 1992

KEY MESSAGES

- Real GDP increased 1.7%[1] in the first quarter, led by a 15.2% gain in exports.
- Canada's inflation rate has fallen to its lowest level in 30 years. In June, the 12-month inflation rate was 1.1%.
- Canada's improved inflation performance has led to continuing declines in interest rates. The Bank Rate in mid-July was 5.61%, its lowest level in 19 years.

SUMMARY

Real GDP increased 1.7% in the first quarter, its largest increase since the second quarter of last year. Final demand (GDP less inventory change) was up 6.4% (Chart 1), led by a 15.2% gain in exports.

Much of the increase in demand was met by a drawdown of inventories, which subtracted 4.5 percentage points from the annualized growth rate of GDP in the first quarter. Inventory positions appear to be relatively lean, implying that further increases in demand should translate quickly into increased production.

The first-quarter gain in real GDP was the fourth consecutive quarterly increase. Growth so far in this recovery, however, has been slow, reflecting weak domestic confidence and sluggish activity in the economies of Canada's major trading partners.

1 Unless otherwise indicated, data and per cent changes are quoted at annual rates. The cut-off date for Statistics Canada data reported here is July 17, 1992.

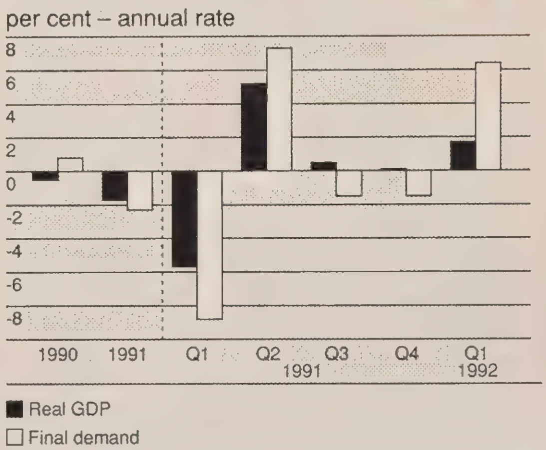
Consumer spending essentially flat in first quarter

Consumer spending fell 0.4% in the first quarter of 1992, as spending on semi-durable and non-durable goods declined. The savings rate in this recovery has shown little decline despite the substantial decline in interest rates.

This reflects, in large part, continued weakness in consumer confidence. Nevertheless, spending on consumer durables increased 5.9% in the first quarter, due mainly to a 19.9% increase in spending on motor vehicle parts and repairs.

Spending on services fell 1.4%, as net consumer expenditures in other countries plunged 53.4%. This decline, in company with the decline in same-day automobile trips by Canadians to the United States in the first quarter, may be a sign that cross-border shopping is beginning to ease.

Chart 1
Change in real GDP and final demand



Residential investment sluggish in first quarter

A drop in housing starts in the first quarter led to a 0.5% decline in real residential investment, after three consecutive large quarterly increases.

Housing starts in the first quarter declined to 153,000 units from 181,000 in the fourth quarter of last year. The decline was concentrated in Quebec, where fourth-quarter numbers were swelled by people taking advantage of the provincial government's "Mon taux, mon toit" program before its expiry.

The second quarter has seen some pick-up in housing market activity. Housing starts increased to 170,000 in the second quarter. Sales of existing houses increased 19.3% in the same quarter.

Investment up marginally in first quarter

Business fixed investment edged up 0.7% in the first quarter. Non-residential construction increased 1.4% as growth in engineering construction, notably hydro-electric projects and pipelines, offset continuing weakness in commercial and industrial construction. Machinery and equipment spending rose 0.2%.

Export surge leads growth in first quarter

Canada's exports of goods and services increased 15.2% in the first quarter. Automobile exports to the United States accounted for almost half the gain in merchandise exports. Also up strongly in the quarter were exports of machinery and equipment and wheat.

Main Economic Indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1991		1992		
	1990	1991	Q3	Q4	Q1	Q2	Most Recent
Real gross domestic product	-0.5	-1.7	0.5	0.1	1.7	–	–
GDP excluding inventories	0.8	-2.3	-1.5	-1.5	6.4	–	–
Final domestic demand	0.2	-1.4	1.1	1.1	0.4	–	–
Consumption	0.9	-1.7	0.5	-0.5	-0.4	–	–
Residential construction	-9.1	-11.8	17.2	8.6	-0.5	–	–
Business fixed investment	-3.3	-1.4	-4.8	7.0	0.7	–	–
Non-residential construction	0.5	-4.1	-7.2	-6.5	1.4	–	–
Machinery and equipment	-5.6	0.5	-3.1	16.6	0.2	–	–
Business inventory investment [1]	-1.3	0.6	2.1	1.6	-4.5	–	–
Non-farm [1]	-1.4	0.8	1.8	1.7	-4.0	–	–
Trade balance [1]	0.6	-0.6	-2.4	-2.0	5.4	–	–
Exports	4.1	0.5	14.9	-8.3	15.2	–	–
Imports	1.9	2.2	22.3	-1.8	-2.9	–	–
Current account balance ($ billion)	-25.7	-29.2	-30.2	-33.2	-28.0	–	–
(% of GDP)	-3.8	-4.3	-4.4	-4.9	-4.1	–	–
Real personal disposable income	0.8	-1.7	-2.1	-3.8	1.0	–	–
Profits before taxes	-24.6	-30.2	-8.3	-43.0	36.3	–	–
Costs and prices (%,y/y)							
GDP price deflator	3.3	2.7	2.5	1.9	0.6	–	–
Consumer price index	4.8	5.6	5.7	4.1	1.6	1.4	1.1 (June)
CPI - excluding food and energy	4.4	5.9	5.8	5.1	2.6	2.0	1.9 (June)
Unit labour costs	5.9	4.6	4.2	2.9	1.0	–	–
Labour market							
Unemployment rate	8.1	10.3	10.4	10.3	10.7	11.3	11.6 (June)
Employment growth (%, a.r.)	0.7	-1.8	0.1	-0.3	-2.1	-2.2	3.0 (June)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.21	86.54	88.33	86.54	84.09	83.43	83.89 (July 16)
Prime interest rate	12.75	8.00	9.50	8.00	8.25	7.00	7.00 (July 16)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Imports fell 2.9% in the first quarter, largely due to a decline in spending by Canadians travelling outside the country.

Growth in exports continued into the second quarter. The April-May average for real merchandise exports was 13.0% above the first quarter level. Real merchandise imports in April and May were virtually unchanged from the first quarter.

Current account deficit improves in first quarter

The current account deficit improved to $28.0 billion in the first quarter of 1992 from $33.2 billion in the fourth quarter of 1991 and a record $29.2 billion for the year as a whole.

An increase in the merchandise trade surplus with the United States was a major contributor to this improvement. The merchandise trade surplus with the United States increased to $17.1 billion in the first quarter from $14.7 billion in the fourth quarter of last year. In May, the surplus was $21.2 billion, its highest level since November 1990.

Despite output gains, employment sluggish as businesses restructure

Despite the gain in output in the first quarter, employment was down 0.5% (quarterly rate).

Employment fell another 0.6% in the second quarter despite increases in May and June. With the May and June employment gains, came even larger increases in the labour force. As a result, the unemployment rate reached a 7 1/2-year high of 11.6% in June.

The weak growth of employment so far in this recovery seems to reflect business restructuring to bring Canadian production costs back into line with those of our major trading partners, particularly the United States. While employment has declined, productivity has increased at a vigorous pace, growing 2.6% over the past four quarters. Such growth is unusual, but encouraging, during a period of general economic weakness.

Inflation rate at 30-year low

The 12-month inflation rate in the CPI dropped to 1.1% in June (Chart 2), the lowest rate since 1962.

Low food prices have helped Canada's inflation performance. Food prices fell 2.2% in the 12 months to June. The rate of inflation excluding food and energy was 1.9% in June.

Wage pressures also ease

Wage increases in major settlements averaged 2.9% in the first quarter. Although the average increase was above that in the fourth quarter, it was well below the

Chart 2
CPI inflation rate

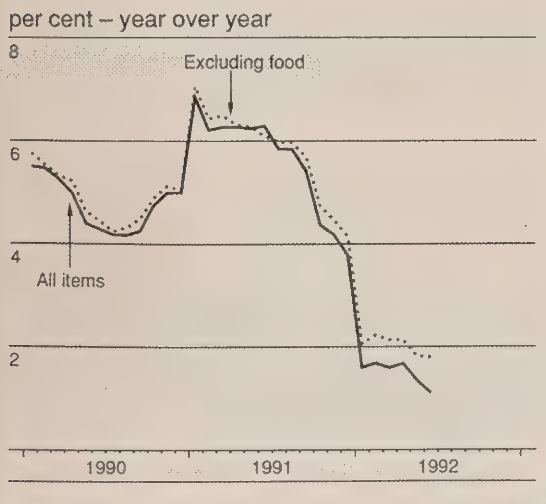
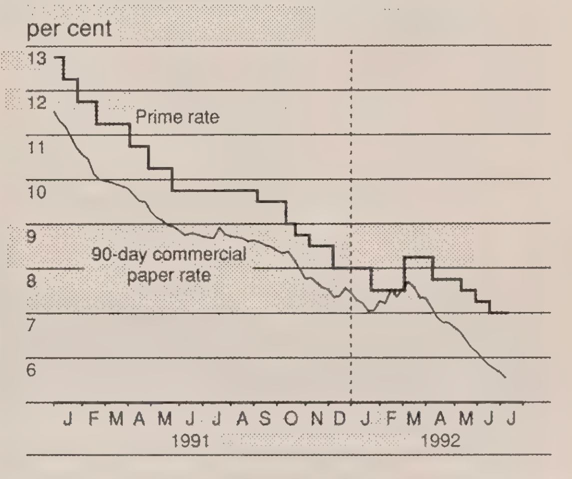


Chart 3
Prime rate and 90-day commercial paper rate, Canada



6.1% figure recorded a year earlier. Public-sector increases averaged 3.0%, down from 6.4% a year earlier, reflecting the impact of wage-restraint programs at both the federal and provincial levels. In the private sector, the first-quarter increase was 2.7%, compared with 5.1% a year earlier, continuing a downward trend that began in the fourth quarter of 1990.

The first quarter figure was the smallest quarterly increase in private-sector wage settlements in over 5 years. Preliminary information for the first two months of the second quarter indicate that private-sector wage settlements have continued to moderate.

With the current low inflation rate, these lower wage settlements still imply real wage gains.

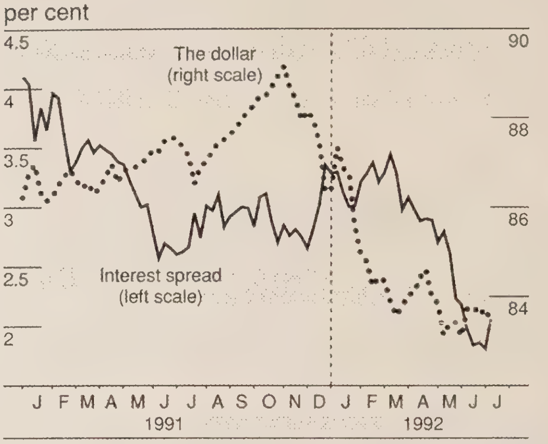
Interest rate decline continues

The decline in interest rates that has been underway since May 1990 continued through the second quarter. Short-term interest rates are at their lowest levels in almost 20 years. The Bank Rate fell to 5.61% in mid-July while the 90-day commercial paper rate fell to 5.49% (Chart 3). The decline in short-term interest rates prompted the chartered banks to lower their prime lending rate to 7.00% in June – one even lowered its prime rate to 6.75%.

Long-term interest rates have also come down recently. Yields on long-term government bonds fell over 80 basis points from the end of April to mid-July.

While the interest rate differential with the United States has narrowed since the spring, the Canadian dollar has generally been stable, fluctuating within the U.S. $0.83 to U.S. $0.84 range (Chart 4).

Chart 4
90-day commercial paper rate differential and the dollar



Historical revisions alter depth of recession

With the release of the first-quarter data, the national accounts were revised back to 1988. The revised data show that the 1990-1991 recession was deeper than previously thought, although the duration remains at four quarters. The peak-to-trough decline in output is now estimated to have been 3.6% compared to the previous estimate of 3.1% and the decline of 5.3% during the 1981-1982 recession. Most of the revision occurred in 1990, where the change in output was revised from growth of 0.5% to a decline of 0.5%.

With the revisions, the current account deficit in 1991 is now estimated at $29.2 billion, compared with the previous estimate of $26.8 billion.

In the February 1992 budget, the Minister of Finance announced that departmental communications budgets would be reduced and the number of government publications cut back. As part of this expenditure reduction program, publication of the Quarterly Economic Review has been stopped. The Economy in Brief will continue to be published in a black-and-white format. The Annual Reference Tables will continue to be published in July of each year.

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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE SEPTEMBER 1992

KEY MESSAGES

- Growth continued at a modest pace in the second quarter. Exports were the main source of growth.
- Canada's inflation performance continues to be the best among the G-7 countries. During the first eight months of 1992, the 12-month rate of CPI inflation averaged 1.4%.
- This inflation performance has allowed steep declines in interest rates. As a result, mortgage rates are at their lowest level in twenty-five years.
- Restructuring is having an important effect on the economy. While this is leaving the economy increasingly well positioned to compete, the accompanying job losses have hindered confidence and made it more difficult for the recovery to take hold.

SUMMARY

The Canadian economy grew at an annual rate of 0.7%[1] in the second quarter, following growth of 1.1% in the first (revised down from 1.7%). Domestically, increases in household spending and in government expenditure were offset by a sharp decline in business investment. Exports, however, registered healthy growth, building on the strong performance in the first quarter. Improved competitiveness contributed to the continued good performance of exports.

The 12-month CPI inflation rate was 1.2% in August and has averaged 1.4% in the first eight months of 1992. Progress in reducing domestic inflation has been supported by strong productivity gains and moderating wage settlements. Corporate profits strengthened for the second consecutive quarter, reflecting the productivity gain and the continued containment of wage costs.

[1] Unless otherwise indicated, data and per cent changes are quoted at annual rates. The cut-off date for data reported in this document is September 18, 1992.

Reflecting this dramatic inflation improvement, Canadian interest rates have continued to decline. The Bank Rate has now fallen more than 200 basis points since January of this year.

Consumer spending rose in the second quarter

Bolstered by a sizeable gain in personal disposable income, consumption rose 1.5% in the second quarter following two consecutive quarterly declines. All components of consumption rose except spending on durables. Spending on cars, furniture and appliances was particularly weak following solid growth in the first quarter. Expenditure on restaurants and hotels increased, ending eight consecutive quarterly declines.

While consumer confidence rose somewhat in the second quarter it remains very weak. Indeed, the fact that the savings rate remains high despite sharp declines in interest rates and inflation, underscores the fragile state of consumer confidence.

Residential investment rebounded

Residential investment was up 6.4% in the second quarter, more than reversing the 4.8% decline in the first. All three components of residential investment rose. New construction grew 4.4% as housing starts increased to 167,000 units from 153,000 units in the first quarter. Spending on renovations and costs associated with resales also increased. More recent data indicate strength in resales, but starts are on average unchanged from second quarter levels.

The strengthened housing market reflects improved affordability brought about by lower mortgage rates. Government policy initiatives, namely the lowering of the minimum downpayment from 10% to 5% on NHA-insured mortgages and the availability of RRSP funds to purchase a house, have also played a role.

Business investment falls sharply

Non-residential business investment declined 11.7% in the second quarter. The current slowing in business investment is consistent with low capacity utilization and weak corporate balance sheets.

Investment weakness in the second quarter was mostly in non-residential construction, which declined 20.3% as both engineering and building construction expenditures decreased. The decline in engineering construction followed a period of steady growth since 1987 due largely to a number of large-scale energy projects. Machinery and equipment spending was also down, though less sharply (6.1%).

Despite its recent downturn, business investment, particularly investment in machinery and equipment, has remained relatively firm through the recent cycle. Business investment was 13% of GDP in the second quarter, compared to a postwar peak of 14.1% in the second quarter of 1989. The resilience of business investment through the recent period of economic weakness bodes well for productivity growth and competitiveness.

Exports continue to show strength

Real exports continued to be a source of growth. They rose 4.6% in the second quarter, building on the 14.4% gain in the first. The fact that exports grew strongly despite the sluggish pace of the U.S. economy underscores the improvement in Canada's competitive situation.

The increase in exports was concentrated in office machines and equipment, natural gas, and autos. Real imports rose 4.1%, with the most notable increases in machinery and equipment, automotive products, and energy products.

Current account deficit remains high

The current account deficit was $29.9 billion in the second quarter, up from $28.5 billion in the first quarter but down relative to an average of $31.7 billion in the second half of 1991.

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1991		1992		
	1990	1991	Q3	Q4	Q1	Q2	Most Recent
Real gross domestic product	-0.5	-1.7	0.5	0.1	1.1	0.7	–
GDP excluding inventories	0.8	-2.3	-1.5	-1.5	5.3	-1.0	–
Final domestic demand	0.2	-1.4	1.1	1.1	-0.6	-0.1	–
Consumption	0.9	-1.7	0.5	-0.5	-1.0	-1.5	–
Residential construction	-9.1	-11.8	17.2	8.6	-4.8	-6.4	–
Business fixed investment	-3.3	-1.4	-4.8	7.0	-2.0	-11.7	–
Non-residential construction	0.5	-4.1	-7.2	-6.5	-5.9	-20.3	–
Machinery and equipment	-5.6	0.5	-3.1	16.6	0.5	-6.1	–
Business inventory investment [1]	-1.3	0.6	2.1	1.7	-4.2	1.8	–
Non-farm [1]	-1.4	0.8	1.8	1.7	-3.4	0.9	–
Trade balance [1]	0.6	-0.6	-2.4	-2.0	4.7	0.0	–
Exports	4.1	0.5	14.9	-8.3	14.4	4.6	–
Imports	1.9	2.2	22.3	-1.8	-1.6	4.1	–
Current account balance (nominal)	-25.7	-29.2	-30.2	-33.2	-28.5	-29.9	–
Current account balance (nominal) (percentage of GDP)	-3.8	-4.3	-4.4	-4.9	-4.2	-4.4	–
Real personal disposable income	0.8	-1.7	-2.1	-3.8	1.4	2.9	–
Profits before taxes	-24.6	-30.2	-8.3	-43.0	49.8	22.2	–
Costs and prices (%, y/y)							
GDP price deflator	3.3	2.7	2.5	1.9	0.9	0.7	–
Consumer price index	4.8	5.6	5.7	4.1	1.6	1.4	1.2 (August)
CPI – excluding food and energy	4.4	5.9	5.8	5.1	2.6	2.0	1.7 (August)
Unit labour costs	5.9	4.6	4.2	2.9	1.1	2.1	–
Labour market							
Unemployment rate	8.1	10.3	10.4	10.3	10.7	11.3	11.6 (August)
Employment growth (%, a.r.)	0.7	-1.8	0.1	-0.3	-2.1	-2.2	1.1 (August)
Financial markets (end of period)							
Exchange rate (U.S. cents)	86.21	86.54	88.33	86.54	84.09	83.43	82.18 (Sept. 18)
Prime interest rate	12.75	8.00	9.50	8.00	8.25	7.00	6.25 (Sept. 18)

[1] Annualized change expressed as a percentage of GDP in the previous period.
Sources: Statistics Canada and the Bank of Canada.

At 4.4% of GDP, the current account deficit remains high by historical standards. Factors behind the increase of the current account deficit in recent years include a deterioration in Canada's terms of trade and the cost of servicing Canada's growing international debt. The deterioration of the travel account balance – which includes cross-border shopping – in recent years has also contributed to the worsening of the current account.

Best inflation performance since 1962

There has been a dramatic improvement in Canada's inflation since 1991 when inflation averaged 5.6%. So far in 1992, the 12-month increases in the CPI have averaged 1.4% while increases in the CPI excluding food and energy have averaged 2.2% (Chart 1). Since January of this year, Canada has had the lowest inflation among G-7 countries.

Productivity continued to rise strongly in the second quarter

Progress on the inflation front has been supported by continued strong productivity gains. Labour productivity rose 3.1%, following growth of 3.5% in the first quarter. These increases are surprisingly strong given the slow output growth experienced so far in the recovery. They indicate that restructuring is having an important influence on the economy.

Wage moderation continues

Wage increases negotiated in major collective agreements averaged 1.6% in the second quarter, the lowest increase in the 14 years for which the data are available. In the private sector, the average increase has now declined for seven consecutive quarters, falling to 2.3% from 6.4% in the third quarter of 1990. Given that inflation is less than 1½%, however, these settlements imply that real wages are increasing.

Canada's competitiveness has improved significantly

The combination of strong productivity gains and moderate wage increases has led to a sharp improvement in unit labour costs. On a year-over-year basis, unit labour cost growth averaged 1.5% during the first half of this year, down sharply from 4.6% in 1991. In the United States, unit labour cost growth averaged 2.3% over the same period.

Taking into account the positive contribution of the depreciation of the Canadian dollar since November 1991, the competitiveness of Canadian exports – as measured by the ratio of Canadian to U.S. unit labour cost – has improved 5.2% since the fourth quarter of 1991 (Chart 2).

This good cost performance underlies Canada's recent strong export performance and has contributed to an improvement in corporate profits, which rose 22.2% in the second quarter following growth of 49.8% in the first.

Chart 1
CPI inflation rate

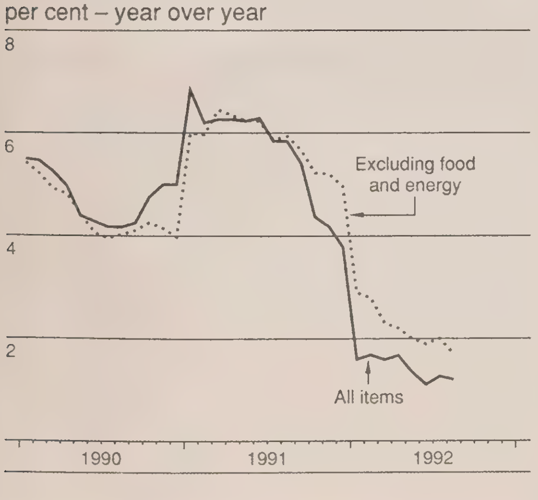
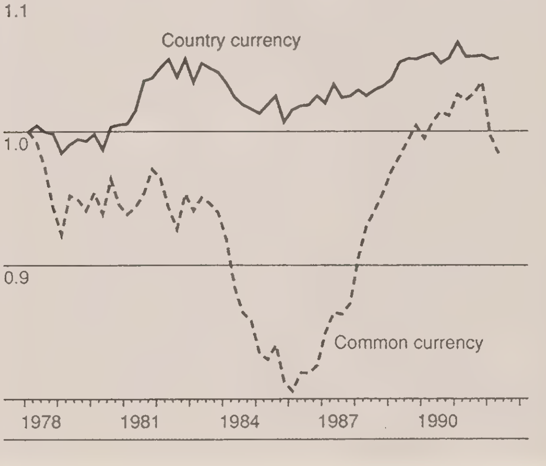


Chart 2
Ratio of Canada to U.S. Unit labour costs



Employment situation improving

Employment rose 0.1% in August. It has risen in three of the last four months for an employment gain of 43,000. The growth in employment has occurred largely in service-producing industries, particularly the trade sector.

The increase in employment, however, did not translate into a lower unemployment rate due to offsetting increases in the labour force. Since May, the unemployment rate has remained stable at 11.6%.

Canadian dollar depreciates

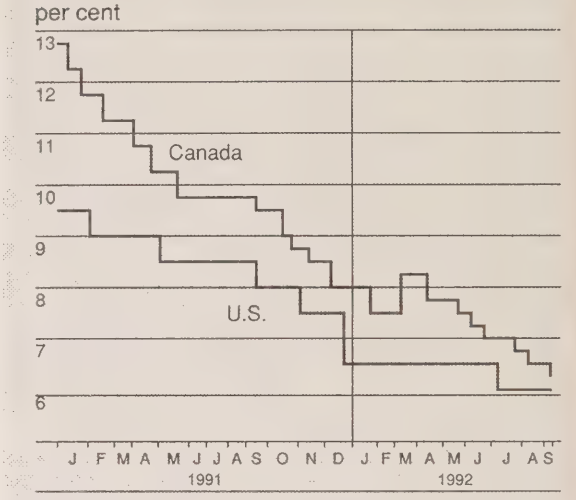
The Canadian dollar was relatively stable against its U.S. counterpart in July and August – generally trading within the U.S. $0.83 to $0.84 band – despite narrowing interest rate differentials.

In the first half of September, international financial markets became extremely unsettled, and European currencies experienced wide fluctuations. The U.S. and Canadian dollars moved down vis-à-vis overseas currencies, and the Canadian dollar weakened somewhat vis-à-vis its U.S. counterpart. On September 18, the Canadian dollar closed at U.S. $0.8218, 1½ cent below its level at the end of August, but was slightly higher relative to the G-9 index, having regained the ground lost in early September.

Interest rates down as inflation declines

The unsettled conditions in international financial markets led to increases in the Bank Rate in mid-September. This interrupted 19 consecutive weekly declines, which had brought the Bank Rate down 204 basis points to 4.93%. Despite these increases, short-term rates are at their lowest levels since 1973. Further, short rates are significantly lower than in the European G-7 countries, where they range from 9 to 17%.

Chart 3
Canada and U.S. prime rates since January 1991



Long-term interest rates eased in July and August but have moved up slightly with the upward pressure on short rates. Yields on long-term government bonds declined almost 100 basis points from July to early September, reaching 7.84%, but have since moved slightly above 8%. The Canada-U.S. differential has narrowed, falling from about 125 basis points at the end of June to 90 basis points on September 18. Canadian long-term interest rates are lower than in the European G-7 countries, except Germany.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre (613) 995-2855. For other inquiries about this publication, contact John Lester (613) 992-9324. Cet imprimé est également offert en français

THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE — DECEMBER 1992

KEY MESSAGES

- Real GDP grew 1.4 per cent[1] in the third quarter.
- An encouraging feature of growth in the third quarter was the solid increase in final domestic demand. The interest-sensitive categories of spending in particular grew strongly.
- The strength of domestic demand in the coming months will be influenced, in part, by interest rate developments. Instability in world financial markets since September has contributed to a rise in short-term interest rates and a sharp fall in the Canadian dollar.
- Canada's inflation performance, which has been the best in the G-7 so far this year, clearly favours a return to much lower interest rates.

SUMMARY

Real GDP increased 1.4% in the third quarter of 1992. While the third quarter represents the sixth consecutive quarter of growth, the pace of the recovery continues to be sluggish.

There were, however, encouraging signs in the third quarter data of a recovery gathering strength. The increase in GDP was the strongest since the second quarter of 1991. Moreover, final domestic demand, up 5.3%, was the main contributor to growth (Chart 1). Household spending on durable goods, residential investment, and business spending on machinery and equipment registered impressive gains, reflecting an improved climate of confidence in the economy due in part to low interest rates. Exports were also up strongly in the quarter.

This strong third-quarter increase in demand, however, was not matched by increased production. Much of the increase in domestic demand was met by increased imports, while the increase in exports was largely satisfied out of inventories.

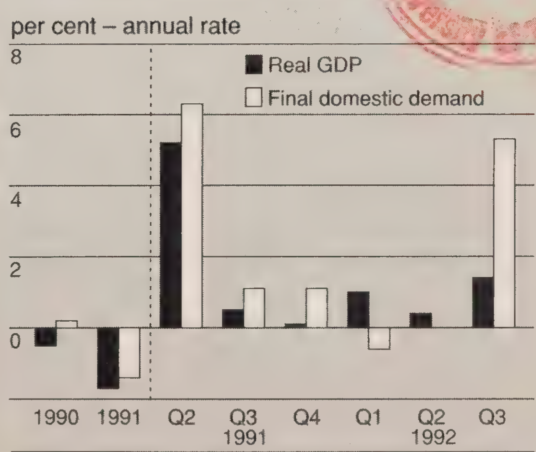
Whether demand will continue to grow strongly will depend to a large extent on interest rates. Instability in world financial markets since early September has contributed to a sharp rise in short-term Canadian interest rates and a decline in the external value of the Canadian dollar.

One of the fundamental determinants of interest rates, however, is market expectations of inflation. Canada's inflation rate, continues to be lower on a sustained basis than at any time in the last 30 years and is the lowest in the G-7 so far this year. The fundamentals, therefore, clearly favour lower interest rates.

Strong gain in consumer spending

Consumer spending increased 3.5% in real terms in the third quarter. Spending on durable and semi-durable goods was up particularly strongly.

Chart 1
Change in real GDP and final domestic demand



1 Unless otherwise indicated, data and per cent changes are quoted at annual rates. The cut-off date for data reported in this document is December 8, 1992.

The growth in consumer spending reflected increased disposable income, as the personal savings rate remained unchanged at 10.9% of disposable income.

The Conference Board of Canada's Index of Consumer Attitudes has rebounded in recent months, increasing 3.5% in the third quarter after a 15.0% gain in the second (Chart 2). As of the third quarter, the index is at its highest level since the fourth quarter of 1989.

Housing investment strengthens in third quarter

Residential investment increased 14.2% in the third quarter as all three major components posted strong advances. New construction was up, reflecting increased housing starts in the second and third quarters. Real estate commissions increased on the strength of increased sales of existing houses in the third quarter. Spending on alterations and improvements also increased in response to increased disposable income and household confidence.

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1990	1991	1992 Q1	1992 Q2	1992 Q3	Most recent
Real gross domestic product	-0.5	-1.7	1.0	0.4	1.4	–
GDP excluding Inventories	0.8	-2.3	4.1	0.6	2.9	–
Final domestic demand	0.2	-1.4	0.6	0.0	5.3	–
Consumption	0.9	-1.7	-0.4	1.1	3.5	–
Residential construction	-9.1	-11.8	-4.0	5.9	14.2	–
Business fixed investment	-3.3	-1.4	-4.0	-6.6	11.6	–
Non-residential construction	0.5	-4.1	-10.3	-22.2	-16.6	–
Machinery and equipment	-5.6	0.5	0.1	4.0	30.2	–
Business inventory investment [1]	-1.3	0.6	-3.0	-0.2	-1.4	–
Non-farm [1]	-1.4	0.8	-2.5	-0.9	0.7	–
Trade balance [1]	0.6	-0.6	4.0	-0.0	-1.3	–
Exports	4.1	0.5	13.6	7.2	7.7	–
Imports	1.9	2.2	-0.1	6.8	11.4	–
Current account balance (nominal)	-25.7	-29.2	-29.2	-29.8	-30.8	–
Current account balance (nominal) (percentage of GDP)	-3.8	-4.3	-4.3	-4.4	-4.5	–
Real personal disposable income	0.8	-1.7	1.9	4.1	2.7	–
Profits before taxes	-24.6	-30.2	52.2	48.4	-24.1	–
Costs and prices (%,y/y)						
GDP price deflator	3.3	2.7	1.1	0.8	0.9	–
Consumer price index	4.8	5.6	1.6	1.4	1.2	1.6 (Oct.)
CPI – excluding food and energy	4.4	5.9	2.6	2.0	1.7	1.7 (Oct.)
Unit labour costs	5.9	4.6	1.0	2.1	2.1	–
Labour market						
Unemployment rate	8.1	10.3	10.7	11.3	11.5	11.8 (Nov.)
Employment growth (%, a.r.)	0.7	-1.8	-2.1	-2.2	0.4	1.3 (Nov.)
Financial markets (end of period)						
Exchange rate (U.S. cents)	86.21	86.54	84.09	83.43	80.24	78.52 (Dec. 8)
Prime interest rate	12.75	8.00	8.25	7.00	8.25	8.75 (Dec. 8)

[1] Annualized change expressed as a percentage of GDP in the previous period.
Sources: Statistics Canada and the Bank of Canada.

In October, both housing starts and resales fell relative to September. Starts recovered to 172,000 units in November, but the October-November average of 167,000 units was down from 176,000 in the third quarter.

Industry modernizing boosts investment

Business fixed investment expanded 11.6% in the third quarter as purchases of computer and other office equipment fuelled machinery and equipment spending. This is consistent with the drive to modernize, cut costs and increase productivity that has been a feature of Canadian industry thus far in the recovery.

Non-residential construction declined in the third quarter, the fifth consecutive quarterly decline. This component continues to reflect the overbuilding of commercial and office space in the 1980s.

Farm inventory drawdown subtracts from growth

Farm inventories declined sharply in the third quarter, as increased exports of wheat were satisfied out of inventories. The swing in farm inventories subtracted 2.2 percentage points from the growth rate of GDP in the third quarter.

Non-farm inventories fell $1 billion in real terms in the third quarter as retailers and manufacturers reduced their stocks. The fall in inventories led to the third consecutive decline in the non-farm inventories-to-sales ratio.

Exports and imports up strongly in third quarter

Exports increased 7.7% in the third quarter, continuing their strong growth since the recovery began. Over the six quarters of the recovery, exports have increased a total of 13.6%. The strength in exports in the third quarter, however, was largely due to wheat. Excluding wheat shipments, exports were unchanged in the quarter.

Imports increased 11.4% in the third quarter. Machinery and equipment comprised a major part of the increase, reflecting the strong growth in business investment in that component.

The strong import growth led to a deterioration in Canada's merchandise trade balance. This contributed to a widening of the current account deficit, which rose to $30.8 billion from $29.8 billion in the second quarter.

Full-time employment up in recent months

Employment increased 13,000 in November, the fourth consecutive monthly increase and the sixth in the last seven months. The cumulative gain in employment over the last seven months is now

Chart 2
Conference Board's Index of Consumer Confidence

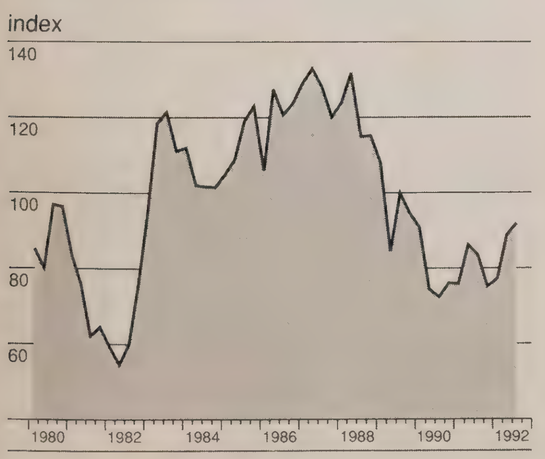
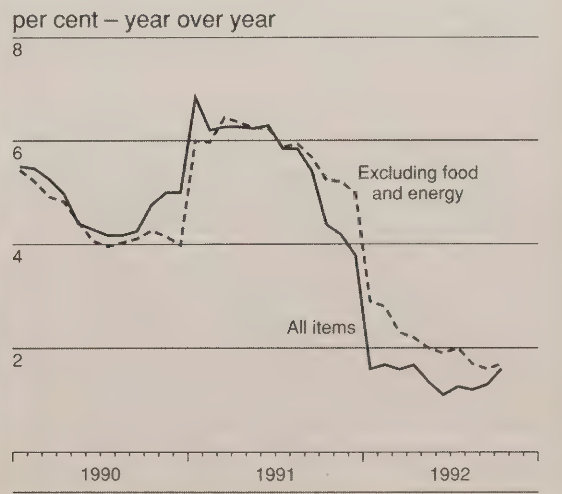


Chart 3
CPI inflation rate



77,000. Recent gains in employment have been concentrated in full-time jobs. Since August, for example, full-time employment has increased 104,000.

The labour force increased an unusually large 97,000 in November. The increase in the adult labour force was the largest on record. As a result, the unemployment rate jumped to 11.8% in November from 11.3% in October.

Inflation rate remains low

In the first ten months of this year, the inflation rate averaged 1.4%, the lowest sustained rate of inflation in 30 years. In October, the inflation rate was 1.6% (Chart 3). The government's and the Bank of Canada's inflation-reduction target of 3.0% by the end of this year should therefore be easily achieved despite the depreciation of the Canadian dollar that has occurred.

Canada's inflation rate is currently less than half the U.S. rate and is the lowest in the G-7 so far this year.

Improved cost performance raises competitiveness

A key element in this improved inflation performance has been unit labour cost growth. Through the first three quarters of this year, unit labour costs have increased at an average rate of 1.8%. This represents a dramatic improvement over early 1991 when unit labour costs were increasing at a rate of 8%. This has also helped Canada's competitive position relative to the United States. When the depreciation of the Canadian dollar is taken into account, Canadian unit labour costs have fallen 6.6% relative to U.S. costs so far this year.

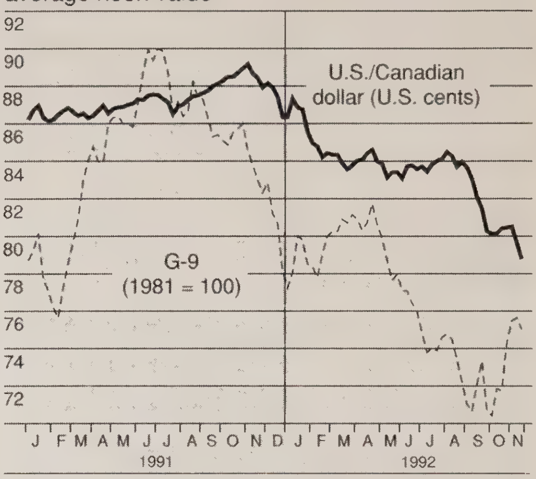
Canada's improved cost performance reflects both improved productivity growth and a slower pace of wage increase. Productivity growth so far this year has averaged 2.6%, a clear improvement over the performance of recent years.

Despite the improved cost performance, profits have been slow to recover. After significant gains in the first and second quarters of this year, corporate profits fell 24.1% in the third. Over the past year, profits are virtually unchanged.

Financial market instability leads to interest rate rise

International financial markets have witnessed a good deal of instability and uncertainty since September. The result has been sharp movements in interest and exchange rates. In Europe, for example, Britain, Sweden, Italy, Spain and a number of other countries had their currencies forced down and interest rates forced up. Canada has not been isolated from this instability.

Chart 4
Foreign price of the Canadian dollar



From early September to late November, short-term interest rates in Canada (90-day commercial paper) rose over 430 basis points. The differential with short-term interest rates in the United States over this period widened from approximately 140 basis points to 514 basis points. In early December, however, markets appear to have stabilized, and short-term interest rates have fallen by 115 basis points since their November peak.

Canadian dollar down

The Canadian dollar fell from U.S. $0.8232 in early September to as low as U.S. $0.7767 in late November (Chart 4). In the wake of the December 2 *Economic and Fiscal Statement,* the dollar rose to over U.S. $0.78.

To some extent, the decline in the Canadian dollar in recent months reflects the strength of the U.S. dollar. Since September, the Canadian currency has actually risen in value against major overseas currencies.

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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE — MARCH 1993

KEY MESSAGES

- The economy strengthened considerably in the fourth quarter with real GDP rising 3.5%.
- The trade sector accounted for all of the growth. An improving U.S. economy and increased Canadian competitiveness led to a 5.5% gain in exports.
- Canada's inflation rate in 1992 was 1.5%, the lowest rate in 30 years and the lowest of the G-7 countries.
- After a period of volatility in the fall, financial markets appear to have stabilized. Interest rates have resumed their downward path.

SUMMARY

Real GDP increased 3.5% in the fourth quarter of 1992, the seventh consecutive quarterly increase, and the largest since the second quarter of 1991. The growth rate for the year was 0.9%, after declines of 1.7% in 1991 and 0.5% in 1990 (Chart 1).

Growth in the fourth quarter was entirely due to strong exports, especially to the United States. Final domestic demand fell 0.8%. Non-residential construction fell sharply once again, the sixth consecutive quarterly decline. As well, the rise in interest rates in late 1992 appears to have at least temporarily shaken consumer confidence.

Domestic inflation remains subdued. The rate of inflation, as measured by the CPI, was 1.5% in 1992, the lowest rate in 30 years. It increased slightly in late 1992 and early in 1993 due to higher import prices resulting from the lower Canadian dollar. This, however, should be a one-time effect. Production cost growth in Canada remains very low.

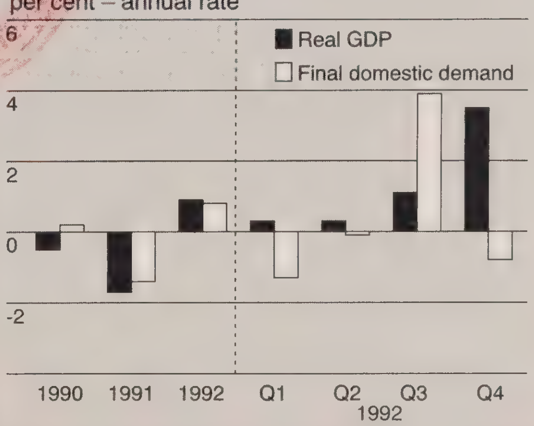
Good inflation performance and prospects have led to a resumption of the declining trend in interest rates.

Consumer confidence shaken in fourth quarter

The rising unemployment rate as well as the increase in interest rates in the fourth quarter appears to have shaken consumer confidence. The Conference Board's Index of Consumer Attitudes dropped 11.3% in the quarter. Lower consumer confidence and a drop in real disposable income resulted in a slowing in consumer spending growth in the fourth quarter, after a strong gain in the third.

Spending on durable goods was up 3.1% in the fourth quarter as household furniture and appliance sales continued to grow in response to stronger sales of houses earlier in the year. Spending on motor

Chart 1
Change in real GDP and final domestic demand



vehicles, however, dropped. Unit sales of automobiles fell in January as well. Spending on semi-durables such as clothing and footwear, was also down in the fourth quarter.

Services expenditures were down in the quarter as spending abroad by Canadians declined sharply, particularly cross-border shopping.

With the decline in real disposable income and spending flat, the personal savings rate fell to 10.0% in the fourth quarter from 10.4% in the third.

Housing sector weakens

The effects of higher interest rates were evident in housing investment in the fourth quarter. After an 11.7% gain in the third quarter, residential investment was flat in the fourth.

The principal source of weakness in residential investment was real estate commissions, as sales of existing houses were down in the quarter. New housing starts were unchanged.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1991	1992	1992 Q2	1992 Q3	1992 Q4	Most recent
Real gross domestic product	-1.7	0.9	0.3	1.1	3.5	–
GDP excluding inventories	-2.3	1.4	1.1	0.9	4.4	–
Final domestic demand	-1.4	0.8	-0.1	3.9	-0.8	–
Consumption	-1.7	1.0	1.9	2.8	0.0	–
Residential investment	-11.8	7.4	7.0	11.7	-0.1	–
Business fixed investment	-1.4	-4.9	-11.1	2.4	-8.1	–
Non-residential construction	-4.1	-15.7	-27.4	-24.7	-25.7	–
Machinery and equipment	0.5	2.2	0.3	20.7	2.0	–
Business inventory investment [1]	0.6	-0.5	-0.7	0.1	-0.9	–
Non-farm [1]	0.8	-0.2	-1.3	2.4	-2.5	–
Trade balance [1]	-0.6	0.7	0.5	-1.6	4.9	–
Exports	0.5	8.2	9.9	10.0	5.5	–
Imports	2.2	5.5	7.6	14.4	-8.5	–
Current account balance (nominal)	-29.2	-28.6	-29.0	-30.2	-26.1	–
Current account. balance (nominal) (percentage of GDP)	-4.3	-4.2	-4.2	-4.4	-3.8	–
Real personal disposable income	-1.7	0.4	4.5	1.9	-2.1	–
Profits before taxes	-30.2	6.7	37.4	-30.3	1.8	–
Costs and prices (%,y/y)						
GDP price deflator	2.7	1.0	0.8	1.2	0.9	–
Consumer price index	5.6	1.5	1.4	1.2	1.8	2.0 (Jan.)
CPI – excluding food and energy	5.9	2.0	2.0	1.7	1.8	2.1 (Jan.)
Unit labour costs	4.6	1.8	2.3	2.2	1.4	–
Labour market						
Unemployment rate	10.3	11.3	11.3	11.5	11.5	11.0 (Jan.)
Employment growth (%, a.r.)	-1.8	-0.8	-1.6	0.5	1.6	0.9 (Jan.)
Financial markets (end of period)						
Exchange rate (U.S. cents)	86.54	78.68	83.41	80.24	78.68	80.37 (Mar. 8)
Prime interest rate	8.00	7.25	7.00	6.25	7.25	6.25 (Mar. 8)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

The weakness in the housing market has carried over into the first quarter of 1993. Sales of existing houses and starts of new houses both dropped sharply in January. Exceptionally cold weather in January, however, may also have contributed to this result. Starts recovered somewhat in February.

Weakness in construction lowers investment

Non-residential construction fell 25.7% in the fourth quarter, the sixth consecutive quarterly decline. Continuing weakness in commercial and industrial construction contributed to the decline. Engineering construction projects, such as electric power plants, pipelines and oil and gas facilities, also weakened.

Despite the continuing weakness of profits, business spending on machinery and equipment increased 2.0% in the fourth quarter as businesses continued to modernize, cut costs and increase productivity. This rise was entirely due to a sharp increase in spending on office equipment; excluding office equipment, machinery and equipment spending fell 16.2%.

Inventories were down in the quarter, leading to a slight decline in the ratio of inventories to sales.

Exports up strongly

Exports increased 5.5% in the fourth quarter, continuing the pattern of strong growth since the start of the year (Chart 2). For the year as whole, exports increased 8.2% after only a 0.5% gain in 1991. Stronger growth in the U.S. economy as well as increased cost competitiveness in Canadian industry were largely responsible for this strong performance.

Imports fell 8.5% in the fourth quarter. Imports of services fell 15.9% as the lower Canadian dollar and an increasingly competitive Canadian retail sector cut into cross-border shopping.

An improved merchandise trade balance reduced Canada's current account deficit from $30.2 billion in the third quarter to $26.1 billion in the fourth. For the year, Canada's deficit was $28.6 billion, a slight improvement from 1991's record $29.2 billion deficit.

Employment growth continues

Employment was up 9,000 in January. While this increase was small (Chart 3), it did represent the eighth increase in the last nine months, bringing the total gain since April to 146,000. The growth in employment has been mainly in full-time employment, which is up 122,000 since April.

Chart 2
Real exports and imports

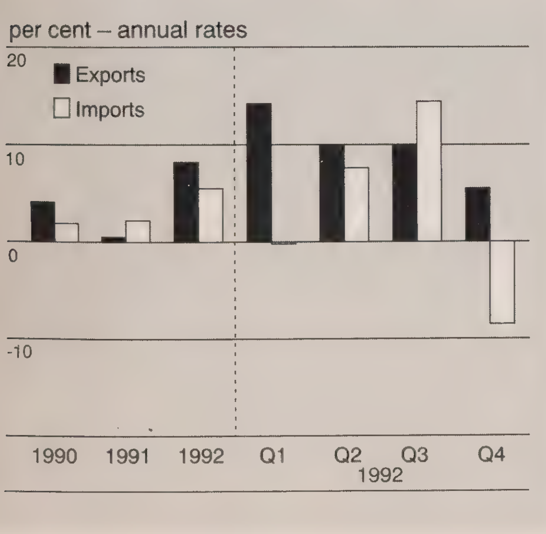
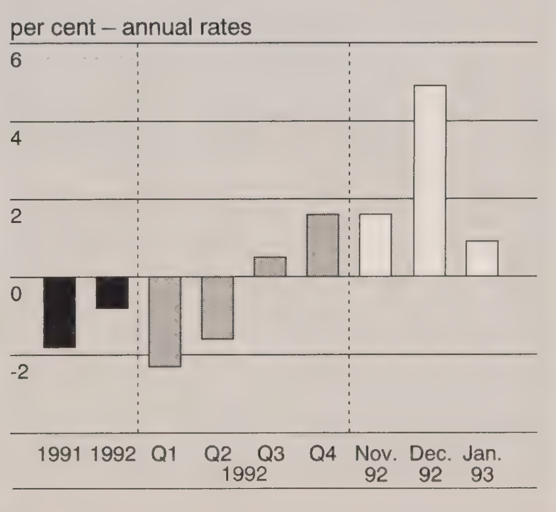


Chart 3
Growth in employment



January's gain in employment coupled with a drop in the labour force produced a decline in the unemployment rate to 11.0%, down from a peak rate of 11.8% in November.

Inflation remains subdued

The CPI inflation rate edged up to 2.1% in December as import prices rose in response to the lower Canadian dollar. This was near the lower band of the joint Government-Bank of Canada inflation-reduction target range of 2.0% to 4.0%. In January, the inflation rate eased slightly to 2.0%.

For 1992, the inflation rate was 1.5%, the lowest annual rate since 1962, and the lowest rate in the G-7.

Another indicator of inflation is the implicit GDP deflator, which excludes imports and measures only the prices of goods and services produced in Canada. In the four quarters to the end of 1992, this index increased only 0.9%.

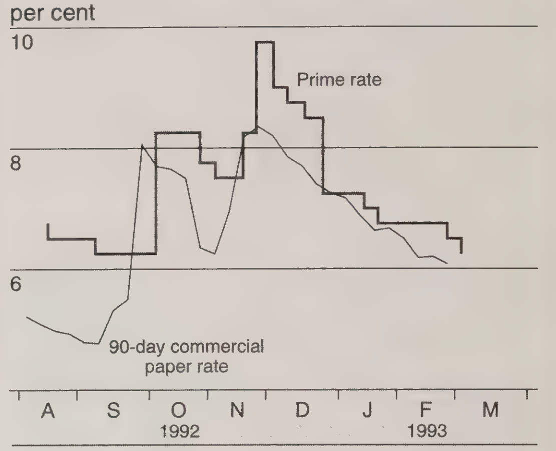
Cost pressures continue to improve

Underlying Canada's improved inflation performance is a much-improved cost performance. Wage increases granted in major collective agreements averaged 2.1% in 1992, the lowest annual figure on record. Yet, with the low inflation rate last year, this still afforded workers a rise in real wages.

The restructuring taking place in Canadian industry is paying off in higher productivity. Labour productivity was up 1.9% last year, the largest gain since 1985. Lower wage and higher productivity growth translated into greatly improved labour cost performance. Unit labour costs in Canada increased 1.8% last year, a sharp reduction from the 4.6% and 5.9% rises in the previous two years.

Together with the lower Canadian dollar, this improved cost performance has greatly increased Canadian competitiveness, a fact reflected in the strong export growth of recent quarters.

Chart 4
Prime rate and 90-day commercial paper rate, Canada



Interest rate decline resumes

The volatility in financial markets in the last quarter of 1992 seems to have subsided. Interest rates have resumed the declining trend begun in May 1990. By early March, short-term interest rates had almost returned to the 20-year lows reached in September of last year (Chart 4). Similarly long-term interest rates have fallen sharply in both Canada and the United States. As of early March, the yields on long-term Canadian government bonds were at their lowest levels in almost 18 years.

Dollar strengthens in recent weeks

After the financial market volatility of the fall, the Canadian dollar stabilized in December and January, and strenghtened in February. The dollar dropped from just under U.S. $0.84 at the end of August to as low as U.S. $0.7767 in November. In December and January, it traded in a narrow range around U.S. $0.785, but more recently has risen to U.S. $0.80.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre (613) 995-2855. For other inquiries about this publication, contact John Lester (613) 992-9324. Cet imprimé est également offert en français.

THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE

JULY 1993

KEY MESSAGES[1]

- Real GDP increased 3.8% in the first quarter of 1993, the largest quarterly increase in almost two years.
- Cost and price pressures remain very low. The CPI inflation rate, for example, was 1.8% in May. Unit labour costs have risen only 1.6% in the last year.
- Canada's low inflation rate has led to a resumption in the downward trend in interest rates. Short-term rates have returned to the 20-year lows established in September of last year.

SUMMARY

Real GDP increased 3.8% in the first quarter of 1993 (Chart 1), the second consecutive quarter of significant growth. The increase in real GDP was led by exports, consumer spending and a reduction in the rate of inventory decumulation. Imports were up even more than exports, rebounding from the decline in the fourth quarter.

The weakest sector was residential investment, where the increase in interest rates in the fourth quarter and cold winter weather combined to produce a sharp decline.

Late last year and early this year, the CPI inflation rate rose slightly as the fall in the Canadian dollar pushed up import prices. Since February, however, the inflation rate has moved down, reaching 1.8% in April and May. Production costs have also been increasing at a slow rate, indicating that inflation is likely to remain low.

Since the upward "spike" in the fall of last year, short-term interest rates have resumed their trend decline. By mid-June, short-term rates had returned to the 20-year lows achieved last September.

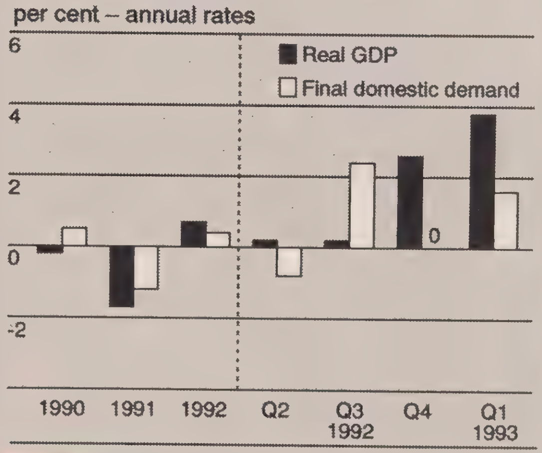
Consumer spending strengthens in first quarter

Consumer spending increased 2.5% in real terms in the first quarter, the strongest quarterly gain in almost two years. The strength in consumer spending was widespread, with all major categories of goods spending showing solid increases. Services spending was up modestly.

The strength in consumer spending reflected solid income gains in the first quarter. Real personal disposable income increased 3.7%, with a 4.3% gain in labour income being the major contributor.

The personal savings rate rose slightly in the first quarter, to 10.7% of disposable income.

Chart 1
Change in real GDP and final domestic demand



[1] Unless otherwise indicated, data and per cent changes are quoted at annual rates. The cut-off date for data reported in this document is June 22, 1993.

Department of Finance Canada
Ministère des Finances Canada

Canada

The strengthening in consumer spending seemed to carry over into the second quarter. Retail sales in April were up 1.0% (monthly rate) led by a strong increase in sales by motor vehicle dealers.

Housing investment down sharply

Investment in residential construction dropped 21.3% in the first quarter, reflecting the spike in interest rates in the last quarter of last year and severe weather conditions in the first quarter.

The component of residential investment posting the sharpest decline was real estate commissions, down 51.7% as sales of existing houses fell sharply in the first quarter. New construction was down 9.1% as new housing starts also fell in the first quarter.

Housing activity seems to have recovered somewhat in the second quarter. Sales in April and May averaged 326,800, up from 249,600 in the first quarter, while starts increased to 159,500 from 145,500 in the first quarter.

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1991	1992	1992 Q3	1992 Q4	1993 Q1	Most recent
Real gross domestic product	-1.7	0.7	0.2	2.6	3.8	–
GDP excluding inventories	-2.1	1.2	2.5	4.0	0.4	–
Final domestic demand	-1.2	0.4	2.4	0.0	1.6	–
Consumption	-2.0	1.1	1.8	0.1	2.5	–
Residential construction	-12.3	6.3	3.8	0.2	-21.3	–
Business fixed investment	1.3	-5.4	3.2	-2.6	5.4	–
Non-residential construction	-2.5	-15.1	-18.2	-22.4	-3.1	–
Machinery and equipment	3.9	0.8	16.9	8.8	9.6	–
Business inventory investment [1]	0.4	-0.5	-2.2	-1.4	3.4	–
Non-farm [1]	-1.3	0.6	-0.2	-3.1	2.9	–
Trade balance [1]	-0.6	0.8	0.2	4.4	-1.5	–
Exports	0.8	7.9	12.4	13.2	5.9	–
Imports	2.7	4.9	11.0	-0.6	10.4	–
Current account balance (nominal)	-29.0	-27.7	-26.8	-23.4	-23.8	–
Current account balance (nominal) (percentage of GDP)	-4.3	-4.0	-3.9	-3.4	-3.4	–
Real personal disposable income	-1.9	1.2	0.4	-2.5	3.7	–
Profits before taxes	-29.2	-4.2	-22.5	27.2	35.0	–
Costs and prices (%, y/y)						
GDP price deflator	2.5	1.1	1.2	1.6	0.8	–
Consumer price index	5.6	1.5	1.2	1.8	2.1	1.8 (May)
CPI – excluding food and energy	5.8	2.1	1.7	1.8	2.1	1.6 (May)
Unit labour costs	4.1	2.3	2.7	2.4	1.6	–
Labour market						
Unemployment rate	10.3	11.3	11.5	11.5	11.0	11.4 (May)
Employment growth (%, a.r.)	-1.8	-0.8	0.5	1.6	2.3	0.0 (May)
Financial markets (end of period)						
Exchange rate (U.S. cents)	86.54	78.68	80.24	78.68	79.46	78.24 (June 22)
Prime interest rate	8.00	7.25	6.50	8.25	6.42	6.00 (June 22)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Industry spending on machinery boosts investment

Investment spending rose 5.4% in the first quarter as spending on machinery and equipment increased 9.6%. Industrial machinery was the main contributor to the increase, another indication of a strengthening outlook for production.

Non-residential construction fell for the fifth consecutive quarter, though the pace of decline slowed to 3.1%. Construction continues to suffer the effects of overcapacity in the commercial and office sector.

Positive swing in inventories contributes to growth

Inventories continued to decumulate in the first quarter, but at a much slower rate than in the fourth quarter of last year. For most of the current recovery, companies have met much of the increase in demand for their goods by drawing down inventories substantially. In the first quarter, however, a greater share of the increase in demand was met by increasing production.

The resulting positive swing in inventories added 3.4 percentage points to the growth rate in the first quarter.

Strong export performance continues

Exports increased 5.9% in the quarter, despite slow growth in the United States, continuing the strong performance of the last two years.

Imports increased 10.4% in the first quarter, with merchandise imports up 13.4%. The solid gains in consumer spending and business spending on machinery and equipment led to strong increases in imports of consumption and investment goods.

Canada's current account deficit was 3.4% of GDP in the first quarter, little changed from the fourth quarter. This nevertheless represents a strong improvement from deficits of 4.3% of GDP in 1991 and 4.0% in 1992.

Employment growth still sluggish

Despite the growth in output, employment growth remains sluggish. Employment increased 2.3% in the first quarter, its largest quarterly gain since the second quarter of 1990, only to fall in April and stagnate in May. Nevertheless, Statistics Canada's Help-wanted Index increased sharply in May, the largest increase since the recovery began in the spring of 1991, which may indicate a firming in the demand for labour.

The unemployment rate fell below 11% in February, but has since increased to 11.4%.

Chart 2
Change in CPI and CPI excluding food and energy

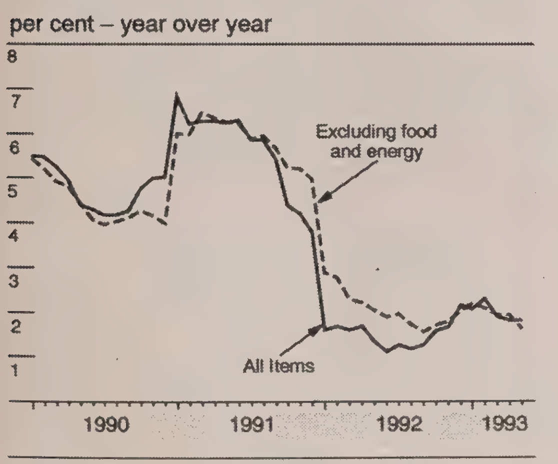
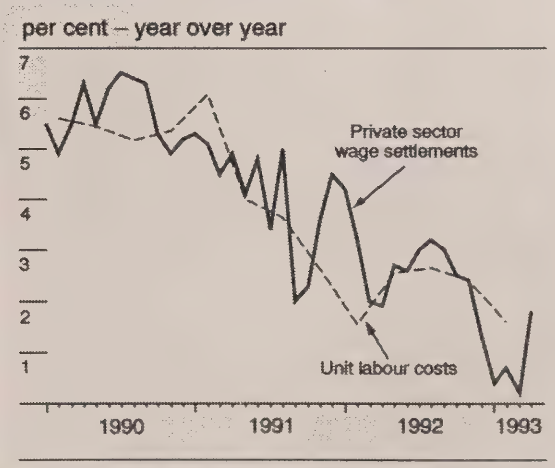


Chart 3
Change in private sector wages and unit labour costs



Inflation rate eases in 1993

Late last year and early this year, the CPI inflation rate edged up to 2.3% as the decline in the value of the Canadian dollar boosted import prices. With the dollar more or less stable in 1993, the inflation rate has eased. In April and May, the rate was 1.8% (Chart 3).

The implicit GDP deflator, which measures the prices of goods and services produced in Canada, and therefore does not reflect import prices, has increased only 0.8% in the past year.

Cost performance improves

Greatly improved cost performance underlies Canada's low inflation rate. Wage increases provided in private sector settlements averaged 0.4% in the first quarter, the lowest quarterly figure since the data have been collected (Chart 3). Negotiated private sector wage increases rose in April, but to a still low 1.8% average.

Smaller wage increases combined with improved productivity has resulted in a dramatic improvement in labour cost performance. Unit labour costs in the first quarter were up only 1.6% from the same period a year ago and have increased at an annual rate of less than 1% in each of the last two quarters.

Profits rebounding

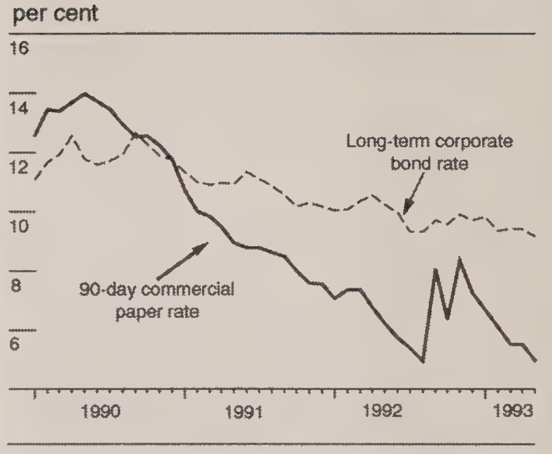
Improved cost performance has also contributed to improved profits. Before-tax profits increased 35% in the first quarter. The recovery in profits, however, is far from complete. They remain at less than half the level attained in the first quarter of 1989.

Interest rate decline resumed

Instability in financial markets contributed to a sharp jump in interest rates in the fall of last year. Since early December, however, short-term interest rates have been moving down (Chart 4). By mid-June, short-term rates had regained the 20-year lows reached last September.

Long-term rates eased slightly since early in the year, but have fallen much more slowly than short-term rates.

Chart 4
Short-term and long-term interest rates



Canadian dollar stable except against yen

Despite some fluctuation, the Canadian dollar in mid-June was at U.S. $0.7846, about the same rate as at the start of the year. Similarly, against major overseas currencies there has been little change since the start of the year.

The Canadian dollar, however, has fallen 17.5% against the yen since the start of the year.

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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE SEPTEMBER 1993

KEY MESSAGES

- Real GDP grew 3.4% in the second quarter after a similar gain in the first. This marks the third consecutive quarter of significant growth.
- Inflation remains near a 30-year low. In July, the 12-month increase in the CPI was 1.6%.
- Instability in foreign exchange markets led to upward pressure on Canadian interest rates in August.

SUMMARY

Real GDP increased 3.4% in the second quarter (Chart 1), due in large part to inventory accumulation. Final domestic demand, particularly household demand, continued to grow modestly, increasing only 1.8%. The increase in output was not sufficient to lower the unemployment rate.

Canada's inflation performance continues to be excellent. The CPI inflation rate, at 1.6% in July, remains near a 30-year low despite a significant decline in the value of the Canadian dollar over the past year. Cost pressures appear to be almost non-existent. Labour costs per unit of output have increased only 0.3% in the past year. Corporate profits posted their third consecutive strong gain, although they remain well below pre-recession levels.

Easing inflation pressures have been behind the more than three-year-old declining trend in interest rates. In early August, the Bank rate fell to 4.20%, its lowest level in 28 years.

Later in the month, however, financial market volatility put upward pressure on Canadian short-term interest rates. Over the past three years, such bouts of speculation have interrupted the declining trend in interest rates. These past interruptions, however, have tended to be brief, and in each case to date, interest rates moved down again in line with Canada's excellent inflation performance.

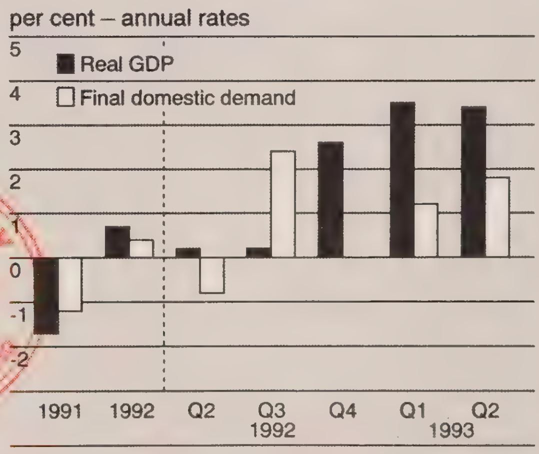
Consumers cautious despite spending increase in second quarter

Consumer spending increased 1.9% in real terms in the second quarter. Spending on discretionary items, such as durable and semi-durable goods, led the advance. Prompting the increase in spending was a 4.3% gain in disposable income.

The underlying outlook for the household sector, however, is cautious. While the gain in personal disposable income in the second quarter was sizeable, it was mostly due to the one-time effects of faster-than-usual processing of tax refunds. Personal income, and its largest component, labour income, registered only small increases.

The cautious mood of consumers was evident in the fact that much of the gain in disposable income was added to savings. The personal savings rate increased from 10.9% of disposable income in the first quarter to 11.2% in the second. Another indicator of household caution is the Conference Board's Index of Consumer Attitudes which declined 12.6% in the second quarter.

Chart 1
Change in real GDP and final domestic demand



Housing resales boost residential investment

Residential investment increased 1.6% in the second quarter. Increased real estate commissions were responsible for the gain. New construction was down in the second quarter as the drop in new starts in the first quarter continued to affect activity.

Housing starts rose to 157,500 in July and August from 153,500 in the second quarter. New construction spending may therefore rise in the third quarter.

Second consecutive solid gain in investment

The cautious outlook of the household sector contrasts with a more buoyant attitude of the business sector. Thus far in 1993, business fixed investment has both gained momentum and become more broadly based.

Non-residential construction posted its second consecutive sizeable increase after falling through most of the previous three years. Spending on machinery and equipment registered another solid gain.

Main economic indicators

(per cent changes at annual rates or per cent levels, unless otherwise indicated)

			1992	1993		
	1991	1992	Q4	Q1	Q2	Most recent
Real gross domestic product	-1.7	0.7	2.6	3.5	3.4	–
GDP excluding inventories	-2.1	1.2	4.0	0.3	0.5	–
Final domestic demand	-1.2	0.4	0.0	1.2	1.8	–
Consumption	-2.0	1.1	0.1	2.1	1.9	–
Residential construction	-12.3	6.3	0.2	-22.5	1.6	–
Business fixed investment	1.3	-5.4	-2.6	5.1	6.9	–
Non-residential construction	-2.5	-15.1	-22.4	4.6	5.0	–
Machinery and equipment	3.9	0.8	8.8	5.4	7.9	–
Business inventory investment [1]	0.4	-0.5	-1.4	3.2	3.0	–
Non-farm [1]	-1.3	0.6	-3.1	2.4	2.6	–
Trade balance [1]	-0.6	0.8	4.4	-1.4	-1.1	–
Exports	0.8	7.9	13.2	6.6	3.7	–
Imports	2.7	4.9	-0.6	10.8	6.9	–
Current account balance (nominal)	-29.0	-27.7	-23.4	-24.9	-27.1	–
Current account balance (nominal) (percentage of GDP)	-4.3	-4.0	-3.4	-3.6	-3.8	–
Real personal disposable income	-1.9	1.2	-2.5	4.0	3.0	–
Profits before taxes	-29.2	-4.2	27.2	39.2	50.7	–
Costs and prices (%, y/y)						
GDP price deflator	2.5	1.1	1.6	0.9	1.1	–
Consumer price index	5.6	1.5	1.8	2.1	1.7	1.6 (July)
CPI – excluding food and energy	5.8	2.1	1.8	2.1	1.7	1.8 (July)
Unit labour costs	4.1	2.3	2.4	1.6	0.3	–
Labour market						
Unemployment rate	10.3	11.3	11.5	11.0	11.4	11.3 (Aug.)
Employment growth (%, a.r.)	-1.8	-0.8	1.6	2.3	0.8	-1.1 (Aug.)
Financial markets (end of period)						
Exchange rate (U.S. cents)	86.54	78.68	78.68	79.46	78.00	75.98 (Sept. 9)
Prime interest rate	8.00	7.25	7.25	6.00	6.00	5.75 (Sept. 9)

[1] Annualized change expressed as a percentage of GDP in the previous period.

Improved business confidence was evident in the Conference Board of Canada's second quarter Survey of Business Attitudes. Confidence increased 2.3% in the second quarter to its highest level in four years.

Recent growth in profits, up 50.7% in the second quarter for the third consecutive quarterly increase, may have contributed to the increase in confidence. At 5.6% of GDP (Chart 2), however, profits remain low in historical terms, just over half the 1970-1990 average of 10.3%

Inventory accumulation major source of growth in second quarter

For the second consecutive quarter a positive swing in inventories was the leading contributor to growth in real GDP. Manufacturing inventories, which registered their first increase in 13 quarters, were the main contributor to the second quarter swing.

This inventory accumulation may be a reflection of the improved profitability and climate of confidence of the business sector. The fact that the inventory-to-sales ratio remains low may be an indication that the increase in inventories was planned.

Slowing in U.S. growth affects Canadian exports

Export growth slowed to 3.7% in the second quarter, the smallest quarterly increase in a year and a half. A slowing in U.S. growth in the first half of the year as well as continuing sluggishness in major overseas economies was largely responsible for the slower growth.

The continuing strong growth in Canadian spending on machinery and equipment was reflected in growth in imports into Canada. Imports were up 6.9% in the second quarter. Over two-thirds of the increase was machinery and equipment.

With the strong increase in imports, and a deterioration in net investment income of almost $1 billion, Canada's current account deficit increased from $24.9 billion in the first quarter to $27.1 billion in the second. This is still smaller than the deficit of $29 billion in 1991.

Employment grows slowly

Employment increased 0.8% in the second quarter. While employment fell in July and August, it was still 0.6% (annual rate) above the second quarter level.

Chart 2
Corporate profits as a share of GDP

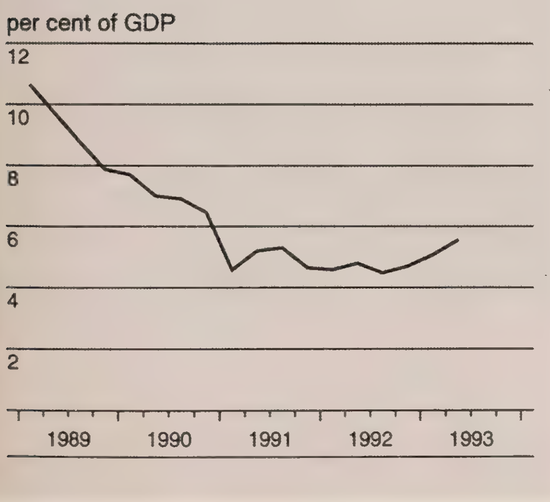
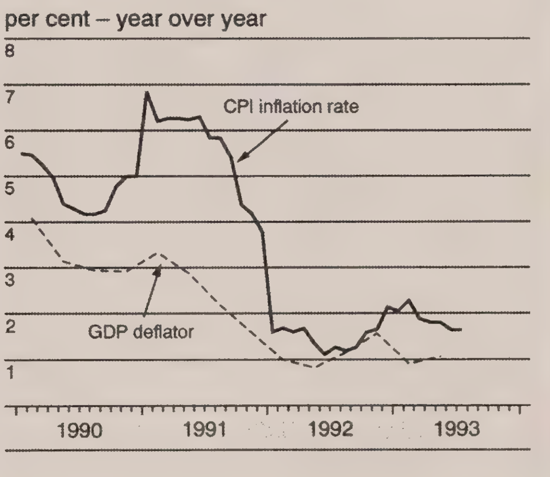


Chart 3
Change in CPI and implicit GDP deflector



The increase in employment this year has not been large enough to absorb all the new entrants into the labour force. As a result, the unemployment rate has risen since the start of the year from approximately 11% to 11.3% in August.

Inflation remains near 30-year low

The CPI inflation rate was 1.6% in July, unchanged from June (Chart 3). The implicit GDP deflator, a measure of the prices of all goods and services produced in Canada, is up only 1.1% from a year ago.

Cost pressures virtually non-existent

Underlying Canada's low inflation rate over the past two to three years is a drastically improved cost performance. Unit labour costs actually fell 2.6% in the second quarter. Over the past four quarters, unit labour costs have increased only 0.3%, the smallest four-quarter increase in 31 years. This contrasts with increases of over 5% per year in 1989 and 1990.

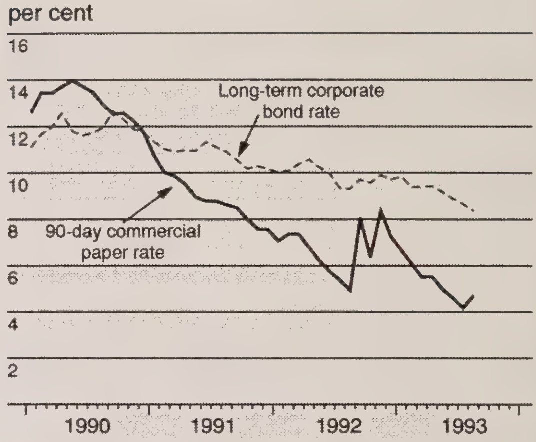
Over the past year, U.S. unit labour costs are up 2.0%. When the lower Canadian dollar is factored in, Canadian unit labour costs over the last four quarters have fallen 7.6% relative to U.S. costs.

The improved cost performance reflects both lower wage growth and faster productivity growth. Wage increases granted in major collective agreements in the private sector this year, for example, have averaged less than 1%. Productivity has been growing strongly; it increased 4.1% in the second quarter.

Financial market instability pushes dollar down, interest rates up

The Canadian dollar, which had been moving down gradually since March, came under significant downward pressure in August. It ended the month at U.S. $0.7577, down almost 2 cents from the beginning of the month. By September 9, it has recovered to almost U.S. $0.7600.

Chart 4
Short-term and long-term interest rates



As investors sold off Canadian dollar denominated short-term assets, interest rates on those assets increased. The 90-day commercial paper rate, for example, rose from almost 4.0% on August 10 to 5.0% on August 12. It remained just below 5.0% for the rest of the month.

The August uptick in interest rates is not a unique event. Since the decline in interest rates began in the spring of 1990, the dollar has several times come under downward pressure which resulted in temporary increases in interest rates (Chart 4). These episodes have been brief, however, and the downward trend in interest rates was soon reestablished.

A key determinant of interest rates is inflation expectations. It is noteworthy that whereas short-term interest rates rose in August, long-term rates continued to ease to their lowest levels in approximately 20 years. This may be a sign that markets expect inflation to remain low.

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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE DECEMBER 1993

KEY MESSAGES[1]

- Real GDP continued to grow modestly in the third quarter.
- Inflation pressures on prices and costs have stabilized.
- With no inflation pressures, interest rates continued to fall in recent months.

SUMMARY

Real GDP rose 2.4% in the third quarter, slightly below the rate during the first half of the year (see Chart 1). The good performance of exports accounted for a large part of third quarter growth. The modest growth reflects weak consumer spending, reduced activity in the construction sector and a drawdown of inventories. Final domestic demand rose only 1.2%.

Domestic inflation pressures are virtually non-existent. Unit labour costs remained unchanged in the third quarter. The CPI inflation rate remained stable at 1.9% in November despite the increase in the cost of imports. The impact of higher import prices on the inflation rate was largely offset by the decline in domestic prices.

With the slow recovery and lack of inflation pressures, the downward trend in short-term interest rates was re-established. The prime interest rate fell to 5.5% during November, its lowest rate since 1962. It is currently 50 basis points below the American rate.

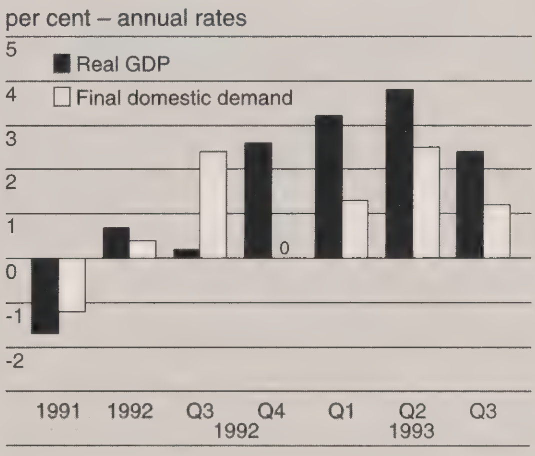
Weak growth in consumer spending

Consumer spending increased only 1.2% in the third quarter. The poor growth reflects low consumer confidence (see Chart 2) due to uncertain employment conditions.

Residential investment declines

The lack of consumer confidence was also felt in the residential sector. In spite of the downward trend in mortgage interest rates in

Chart 1
Change in real GDP and final domestic demand



[1] Unless otherwise indicated, data and per cent changes are quoted at annual rates. The cut-off date for data reported in this document is December 20, 1993.

recent months, residential investment fell 7.8% in the third quarter. Investment in new housing and real estate commissions on sales of existing homes both declined, while spending on home improvements and renovations rose slightly.

Housing starts rose by 3.1% in November to 171,300 units (after an increase of 5.7% in October), which is still well below the 200,000 units needed to meet demographic demand. However, the upward trend in October and November suggests that residential investment will increase in the fourth quarter.

Main economic indicators

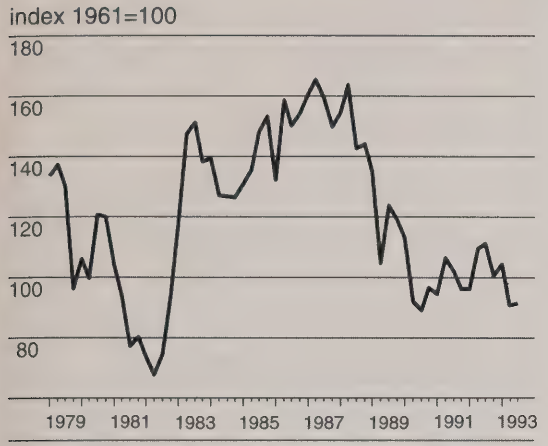
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1991	1992	1993 Q1	1993 Q2	1993 Q3	Most recent
Real gross domestic product	-1.7	0.7	3.2	3.8	2.4	–
GDP excluding inventories	-2.1	1.2	0.0	1.8	4.4	–
Final domestic demand	-1.2	0.4	1.3	2.5	1.2	–
Consumption	-2.0	1.1	2.9	2.1	1.3	–
Residential construction	-12.3	6.3	-21.3	8.5	-8.0	–
Business fixed investment	1.3	-5.4	4.5	7.5	7.5	–
Non-residential construction	-2.5	-15.1	0.4	8.8	-10.2	–
Machinery and equipment	3.9	0.8	6.5	6.9	16.5	–
Business inventory investment [1]	0.4	-0.5	3.2	2.0	-2.0	–
Non-farm [1]	0.6	-0.2	2.4	1.6	-2.4	–
Trade balance [1]	-0.6	0.8	-0.5	0.0	0.8	–
Exports	0.8	7.9	5.8	8.3	7.8	–
Imports	2.7	4.9	11.8	8.3	-1.8	–
Current account balance (nominal)	-29.0	-27.7	-26.3	-26.2	-25.2	–
Current account balance (nominal) (percentage of GDP)	-4.3	-4.0	-3.7	-3.7	-3.5	–
Real personal disposable income	-1.9	1.2	5.5	1.6	0.2	–
Profits before taxes	-29.2	-4.2	33.2	41.2	0.8	–
Costs and prices (%, y/y)						
GDP price deflator	2.5	1.1	-0.3	1.2	-0.4	–
Consumer price index	5.6	1.5	2.1	1.7	1.7	1.9 (Nov.)
CPI – excluding food and energy	5.9	2.0	2.1	1.7	2.0	2.1 (Nov.)
Unit labour costs	4.1	2.3	0.7	-3.0	0.0	–
Wage settlements (total)	3.6	1.5	1.3	0.4	0.7	2.3 (Oct.)
Labour market						
Unemployment rate	10.3	11.3	11.0	11.4	11.4	11.0 (Nov)
Employment growth (%, a.r.)	-1.8	-0.8	2.3	0.8	1.0	0.5 (Nov)[2]
Financial markets (average)						
Exchange rates (U.S. cents)	87.28	82.90	79.28	78.73	76.69	74.40 (Dec 20)
Prime interest rate	10.10	7.55	6.58	6.00	5.77	5.50 (Dec 20)

1 Annualized change expressed as a percentage of GDP in the previous period.
2 Monthly rate.

Sources: Statistics Canada and the Bank of Canada.

Chart 2
Consumer confidence index



Source: Conference Board of Canada.

Third consecutive gain in non-residential investment

Strong non-residential investment continued in the third quarter with growth of 7.5%. The improvement is attributable entirely to an increase of 16.5% in machinery and equipment spending. Increased investment was felt in a number of different fields including computer equipment and industrial equipment. Non-residential construction continued its downward trend, falling 10.2%.

Inventory drawdown

Businesses drew down their inventories in the third quarter, with the result that current inventory levels remain low. Production should rise as demand increases.

Increased competitiveness results in improved trade balance

The upward trend in exports continued in the third quarter. The strength of the American economy and Canada's improved competitiveness accounted for a 7.8% increase in exports in real terms in the third quarter.

Imports fell by 1.8% in real terms, despite strong growth in machinery and equipment spending. The improvement in the services balance is due in large part to reduced cross-border shopping. The drop in imports is attributable to weak domestic demand as well as to higher import prices.

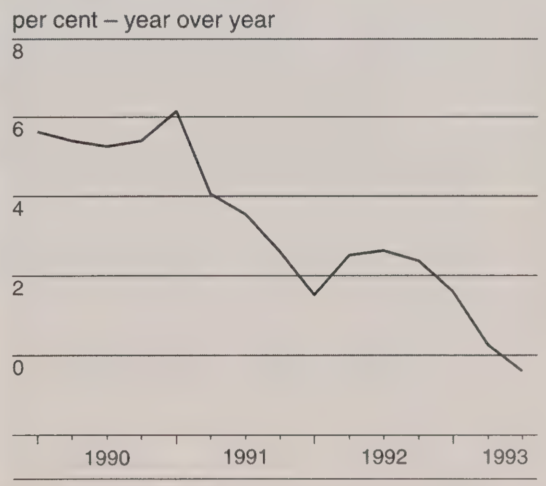
Due in large part to the improvement in the balance of trade, the current account deficit fell by $1 billion in the third quarter to $25.2 billion.

Growth in employment remains modest

In October and November, on average, employment grew 0.8% compared to the third quarter. This growth was roughly the same pace as in the previous two quarters. In the last six months, the growth in employment has been concentrated in British Columbia and Alberta.

The unemployment rate has been falling slowly since July, dropping from 11.6% to 11% in November. However, this decline is

Chart 3
Unit labour costs



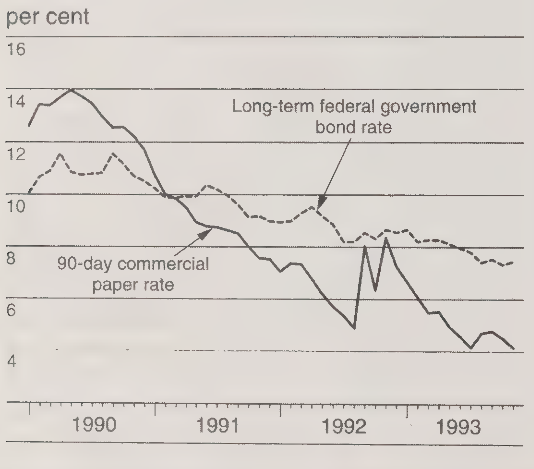
attributable in part to a reduction in the labour force during this period.

Stabilization of inflation pressures

The CPI inflation rate has stabilized in recent months. It reached 1.9% in November, almost a full percentage point below the rate in the United States. The increase in the CPI in 1993 has been fuelled by higher import prices. The implicit GDP deflator, a measure of the prices of all goods and services produced in Canada, has remained virtually unchanged since the end of 1992.

Underlying Canada's low inflation rate over the past two to three years is a major reduction in inflation pressures coming from production costs. In the third quarter, for the first time since 1962, unit labour costs were down on a year-over-year basis. The improved cost performance reflects both moderate wage growth and strong productivity growth. Wage increases averaged only 0.7% in the third quarter while productivity grew 1.4%.

Chart 4
Short-term and long-term interest rates



Continued improvement in monetary conditions

During the third quarter, instability in exchange markets resulted in a temporary increase in short-term interest rates. The 90-day commercial paper rate reached 4.92% in early September (Chart 4). In spite of the continued volatility of the dollar, the slow recovery and the absence of inflation pressures contributed to a decline in interest rates in subsequent months. As of December 20, the 90-day commercial paper rate had fallen to 4.05%. The prime interest rate fell 25 basis points in November to 5.5%, 50 basis points below the American rate.

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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE MARCH 1994

KEY MESSAGES

- Growth strengthened in the fourth quarter but remains insufficient to lower unemployment significantly.
- Inflationary pressures are extremely low and falling unit labour costs are contributing to strong gains in corporate profitability.
- Recent increases in U.S. interest rates have put upward pressure on Canadian rates.

SUMMARY[1]

Real GDP increased 3.8% in the fourth quarter of 1993 (see Chart 1). The gain was fuelled by strong growth in business non-residential investment and exports. Households, however, remained cautious and consumer spending and residential investment continued to show the modest growth evident all year. For 1993 as a whole, real GDP was up 2.4%.

Output growth continued to outstrip employment growth by a wide margin, leading to strong growth in output per worker. This strong growth in labour productivity, combined with weak growth in average wages, has kept domestic cost pressures virtually non-existent in 1993. CPI inflation fell to 1.3% in January 1994.

With inflation low and falling, Canadian interest rates continued to ease until mid February when U.S. rates started to rise, pushing Canadian rates up.

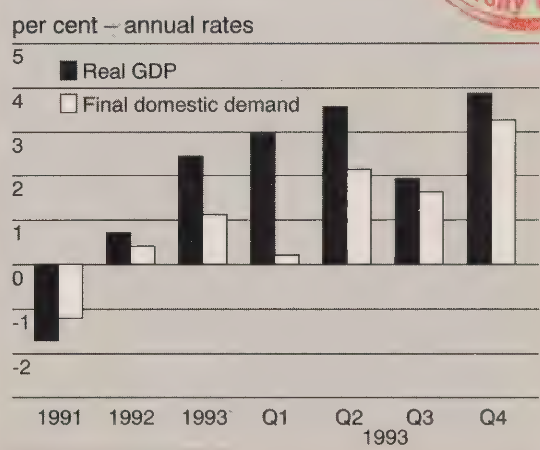
[1] Unless otherwise indicated, data and per cent changes are quoted at annual rates. The cut-off date for data reported in this document is March 4, 1994.

Exports and investment fuelling growth

As has been the case since late 1992, exports and business non-residential investment were the key sources of strength, up 14.1% and 17.0% respectively in the fourth quarter. Export growth was spurred by the strengthening U.S. economy and the ongoing improvements in Canadian competitiveness.

The growth in business investment became more broadly based, with both machinery and equipment and non-residential construction activity up strongly. The latter showed its first broadly-based gain since before the recession, but remains around 25% below its pre-recession peak. In contrast, M&E investment stayed much stronger during the recession and early recovery and has been strengthening through 1993.

Chart 1
Growth in real GDP and final domestic demand



Investment should continue to be a source of strength in 1994. In the fourth quarter, the Conference Board's Index of Business Confidence rose to its highest level since early 1989, with the share of businesses that felt it is a good time to invest up substantially.

As well, the latest Private and Public Investment (PPI) intentions survey showed that Canadian businesses intend to spend 4.3 per cent more on non-residential investment in 1994 than they did in 1993, with that spending growth evenly split between M&E and non-residential construction.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1992	1993	1993: Q2	1993: Q3	1993:Q4	Most recent
Real gross domestic product	0.7	2.4	3.5	1.9	3.8	–
GDP excluding inventories	1.2	1.7	1.3	3.8	2.3	–
Final domestic product	0.4	1.1	2.1	1.6	3.2	–
Consumption	1.1	1.6	2.0	1.4	1.8	–
Government expenditure	0.7	0.2	-0.9	-0.7	-1.0	–
Residential construction	6.3	-3.8	7.4	-5.1	4.8	–
Business fixed investment	-5.4	2.3	6.0	9.8	17.0	–
Non-residential construction	-15.1	-9.2	6.0	-8.5	9.0	–
Machinery and equipment	0.8	8.5	6.0	19.2	20.7	–
Business inventory change[1]	-0.5	0.7	2.2	-1.8	1.5	–
Trade balance[1]	0.8	0.5	-0.9	2.3	-0.6	–
Exports	7.9	9.6	8.8	7.8	14.1	–
Imports	4.9	7.6	11.1	0.9	15.5	–
Current account balance	-27.7	-25.2	-26.0	-24.6	-24.2	–
(percentage of GDP)	-4.0	-3.5	-3.7	-3.5	-3.4	–
Real personal disposable income	1.2	1.2	3.9	-5.2	-4.3	–
Corporate profits before taxes	-4.2	19.8	34.6	-11.7	72.9	–
Costs and Prices (%, y/y)						
GDP price deflator	1.1	0.8	1.1	0.7	0.5	–
CPI – total	1.5	1.8	1.7	1.7	1.8	1.3 (Jan.)
CPI – excluding food and energy	2.0	2.0	1.7	2.0	2.1	1.7 (Jan.)
Unit labour costs	2.3	0.2	0.4	-0.1	-0.9	-1.4 (Nov.)
Wage settlements (total)	2.1	0.7	0.4	0.7	0.8	0.2 (Dec.)
Labour market						
Unemployment rate	11.3	11.2	11.3	11.3	11.1	11.4 (Jan.)
Employment growth (%, a.r.)	-0.8	1.2	1.0	1.0	1.4	-3.7 (Jan.)[2]
Financial markets (average)						
Exchange rates (average)	82.80	77.55	78.73	76.71	75.48	73.68 (Mar. 4)
Prime interest rate	7.48	5.94	6.00	5.75	5.58	5.50 (Mar. 4)

[1] Annualized change expressed as a percentage of GDP in the previous period.
[2] Monthly rate.

Sources: Statistics Canada and the Bank of Canada.

Household sector still lacking confidence

The cautious household sector remains the primary impediment to stronger economic growth. Automotive purchases led a modest 1.8% gain in real consumer spending in the fourth quarter, similar to the pace evident all year long. The growth occurred despite falls in real personal disposable income in both the third and fourth quarters, due principally to strong increases in personal income taxes stemming from the 1993 provincial budgets. As a result, the personal savings rate fell in the second half of the year.

Residential investment also remains weak, despite substantial improvements in housing affordability coming from record low mortgage rates. Housing starts increased slightly in the fourth quarter, but then fell to 143,000 units in January, in part due to unusually cold weather.

The caution evident in consumer spending and housing markets reflects continuing low levels of consumer confidence. Although confidence rose in the fourth quarter, it remains 7% below its level just before the recession, due principally to ongoing insecurity about future job prospects.

Inventories contribute to growth

Businesses accumulated inventories in the fourth quarter after a decline in the third. The gain was largely in the trade sector, following a large decline in the third quarter. Manufacturing inventories declined in the quarter and for the year as a whole, as they have in every year since 1989.

Trade balance deteriorates in fourth quarter but up strongly for 1993

While exports grew strongly in the fourth quarter, imports grew even faster and the trade balance declined slightly. Growth in imports was fuelled by gains in automobiles, industrial products and machinery and equipment. For 1993 as a whole, the nominal merchandise trade surplus increased $2.7 billion and the current account deficit declined $2.5 billion.

Employment growth still weak

Despite the gain in production, total employment continues to show only modest growth, in the 1 to 1½% range on a year-over-year basis, with gains in some months and losses in others.

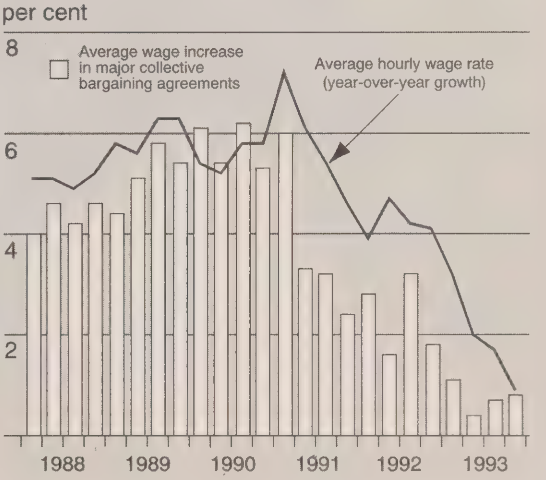
This continued a pattern evident since 1992 of production gains greatly outstripping employment gains. For 1993 as a whole, output per worker was up 1.2% after a gain of 1.5% in 1992.

The weakness in employment growth reflects both the weakness in output growth – which remains well below that experienced in the recovery from the 1981-1982 recession – and employer efforts to cut costs in the face of minimal increases in producer prices.

Inflation pressures virtually zero

By almost any measure, domestic inflation pressures are almost non-existent in Canada. Growth in average wages and salaries per employed person has been falling as new wage settlements drop (Chart 2). Unit labour costs fell

Chart 2
Growth in wages in Canada



on a year-over-year basis in the third and fourth quarters and were virtually unchanged for 1993 as a whole.

The GDP deflator, the broadest measure of domestic inflationary pressures, was up 0.8% in 1993. The CPI increased 1.8% for the year, as consumer prices reflected increased prices for imported goods and services resulting from the fall in the Canadian dollar.

In January 1994, CPI inflation fell to 1.3%. When the recently-announced tobacco tax cuts come into effect in February, Canadian CPI inflation will fall below 1 per cent.

Corporate profits up sharply

With unit labour costs falling, corporate profits surged in the fourth quarter. For the year, profits recorded a 19.8% increase, after falling for four consecutive years. Yet, at 5.9% of GDP in the fourth quarter, profits remain well below pre-recession norms (Chart 3).

Chart 3
Share of corporate profits in GDP

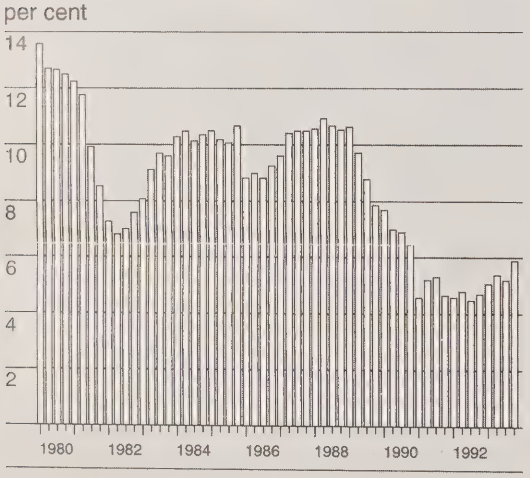
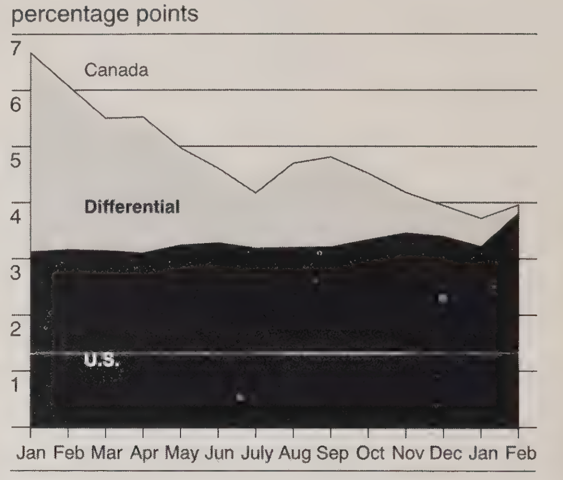


Chart 4
90-day commercial paper rate



Rising U.S. interest rates stall Canadian rate decline

With Canadian inflationary pressures low, Canadian interest rates continued to decline through January 1994.

Early in February, however, the U.S. Federal Reserve Board announced that it was moving to a more-neutral monetary stance given the low level of real interest rates in the U.S and the recent robust growth of the U.S. economy. This prompted downward pressure on the Canadian dollar and upward pressure on Canadian interest rates – at both the short and long end of the maturity spectrum.

Canadian rates have subsequently moved back up. Short rates are back to levels of last December (Chart 4) while 10-year Government of Canada bond rates are back to levels of last summer.

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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE DECEMBER 1994

KEY MESSAGES

- Real GDP grew 4.7% in the third quarter and an average of 5.0% since the beginning of the year – the best economic performance in more than six years. Employment growth in the third quarter was the best in five years with strong growth continuing in the fourth quarter.
- As a result of a record improvement in the merchandise trade surplus, the current account deficit fell from $30.2 billion in the second quarter to $20.5 billion, its lowest level in four years.
- Despite this strong growth, domestic cost pressures remain subdued, as unit labour costs fell for their fourth consecutive quarter.
- Financial market volatility and increases in U.S. interest rates have put upward pressure on Canadian interest rates and downward pressure on the Canadian dollar.

SUMMARY[1]

The Canadian economy continued to expand at a robust pace in the third quarter. International trade remains the primary engine of growth, spurred by ongoing gains in competitiveness and strong international demand. Business investment also remained buoyant in response to surging profits and improved confidence. In contrast, growth of household sector spending has been sluggish due to income weakness.

Underlying domestic inflation pressures remain weak. Unit labour costs declined for the fourth quarter in a row and most indicators of domestic price pressures are subdued.

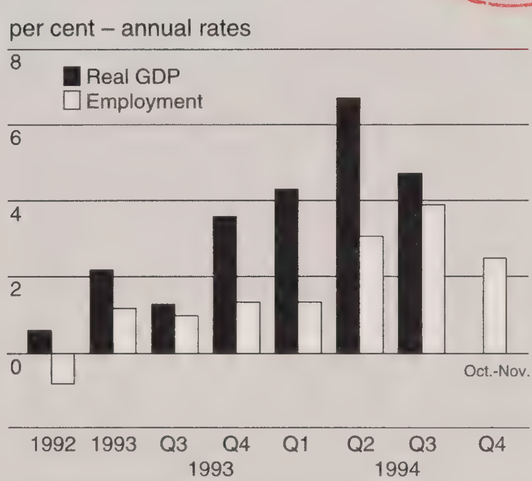
[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data reported in this document is noon, December 14, 1994.

Partly in response to hikes in the U.S., short-term interest rates in Canada increased about 190 basis points between September 30 and December 13, with more than half the increase occuring in December. At the same time, the Canadian dollar depreciated to around 72 cents U.S., after increasing from 72 ¼ cents in June to almost 74 ½ cents by the end of September.

Modest household spending growth

The growth in real consumer spending slowed only slightly in the third quarter, despite a 2.7% decline in real disposable income. This led to a further decline in the personal savings rate to 6.7% in the third quarter (Chart 2) to its lowest level in 23 years. The strong downward trend in the savings rate since mid 1992 is a reflection of rising consumer confidence and employment gains, which have encouraged consumers to finance increased spending by reducing the percentage of their income that is saved.

Chart 1
Real GDP and employment



[1] Average of October and November employment relative to its third quarter average.

Despite the fall in disposable income, spending increased for most categories of consumer expenditures. The one exception was interest-sensitive consumer durables spending, which declined 3.6% in the third quarter, partially in response to interest rate increases earlier in the year.

The weakest area of household spending was residential investment, which is also very sensitive to interest rates. It declined 13.1% in the third quarter due largely to a sharp decline in existing homes sales. Recent indicators suggest that residential investment remains weak in the fourth quarter. Both housing starts and house resales declined at the beginning of the fourth quarter to levels well below the third quarter average.

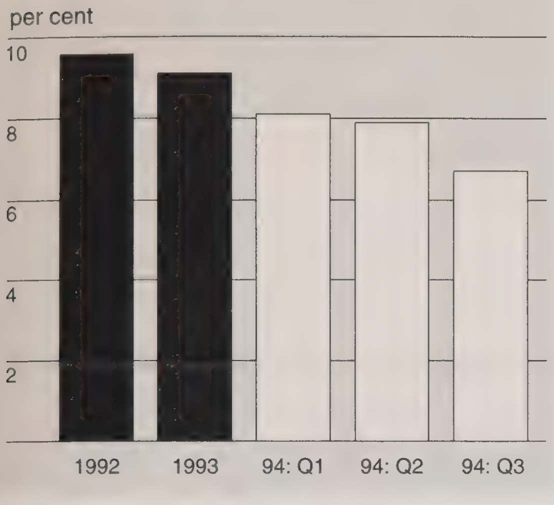
Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1992	1993	1994: Q1	1994: Q2	1994: Q3	Most recent	
Real gross domestic product	0.6	2.2	4.3	6.7	4.7	–	
GDP excluding inventories	0.7	1.4	4.4	5.6	6.0	–	
Final domestic product	0.4	1.0	2.4	3.6	1.1	–	
Government expenditure	1.0	1.0	-3.9	-2.5	-0.6	–	
Consumer expenditure	1.3	1.6	5.1	3.0	2.6	–	
Residential investment	7.9	-4.4	1.8	16.9	-13.1	–	
Business fixed investment	-7.5	0.7	2.6	12.6	3.6	–	
Non-residential construction	-16.2	-9.3	-9.1	10.0	8.3	–	
Machinery and equipment	-2.0	6.2	8.3	13.7	1.7	–	
Business inventory change[1]	-0.1	0.8	-0.1	1.1	-1.3	–	
Trade balance[1]	0.4	0.3	0.8	2.2	4.3	–	
Exports	7.7	10.4	4.1	22.2	21.4	–	
Imports	5.9	8.8	1.7	14.5	8.3	–	
Current account balance (nominal)	-26.5	-30.7	-29.8	-30.2	-20.5	–	
(percentage of GDP)	-3.8	-4.3	-4.1	-4.1	-2.7	–	
Real personal disposable income	1.0	0.8	8.0	2.1	-2.3	–	
Profits before taxes	-1.9	20.3	73.6	43.4	58.4	–	
Costs and prices (%, y/y)							
GDP price deflator	1.4	1.1	0.9	0.3	0.7	–	
Consumer price index	1.5	1.8	0.6	0.0	0.2	-0.2	Oct-94
CPI – excluding food and energy	2.0	2.0	0.7	0.0	-0.1	-0.3	Oct-94
Unit labour costs	1.8	0.3	-1.2	-0.6	-1.3	-0.4	Sep-94
Wage settlements (total)	2.1	0.7	0.6	0.2	0.3	-0.1	Sep-94
Labour market							
Unemployment rate	11.3	11.2	11.0	10.7	10.2	9.6	Nov-94
Employment growth (%, a.r.)	-0.8	1.2	1.3	3.1	3.9	9.3	Nov-94[2]
Financial markets (average)							
Exchange rates (average)	82.80	77.55	74.57	72.34	72.93	72.08	13-Dec-94
Prime interest rate	7.48	5.94	5.75	7.17	7.25	8.00	13-Dec-94

[1] Annualized change expressed as a percentage of GDP in the previous period.
[2] Monthly rate.

Sources: Statistics Canada and the Bank of Canada.

Chart 2
Personal savings rate



Strong employment growth continues

A sustained increase in employment this year (Chart 1) has been a major factor strengthening consumer confidence, which reached its highest level in five years in the third quarter. Since January, employment has increased 402,000, all of which has been in full-time jobs. In November alone, employment increased 95,000, matching the largest monthly gain on record in September 1980. The fastest employment growth this year has been in goods-producing industries, particularly export-oriented manufacturing industries and construction.

This rapid growth in employment combined with little change in the participation rate has led to a sharp decline in the unemployment rate from 11.2% in December of last year to 9.6% in November. Furthermore continued gains in the Help Wanted Index, which is a leading indicator of employment growth, suggest that the improvement in labour markets is likely to continue.

Business investment remains strong

Growth in business fixed investment remained strong in the third quarter, although down from the spectacular growth in the previous quarter. Non-residential construction increased 8.3%. On the other hand, growth in machinery and equipment investment slowed in the third quarter from its rapid pace in recent quarters. The slowdown was largely due to a sharp decline in automobile and truck purchases, which tend to be volatile from quarter to quarter. Other components, such as industrial machinery and office equipment investment continued to grow rapidly.

This continued strong growth in investment has been supported by capacity utilization rising to above its historical average in the third quarter and surging profits, up more than 80% over the past eight quarters. As a result, the Conference Board's Index of Business Confidence rose again in the third quarter to its highest level since 1979, with a record 81% of firms planning to increase investment in the next six months.

Inflationary pressures

Domestic inflation pressures remain low despite continued strong growth. The domestic demand deflator, which is the broadest measure of inflation for goods and services consumed in Canada, rose only 0.6% at annual rates in the third quarter. While the GDP deflator, an indicator of the price of goods produced in Canada, rose 2.3%, this was largely due to strong increases in world prices for exported goods.

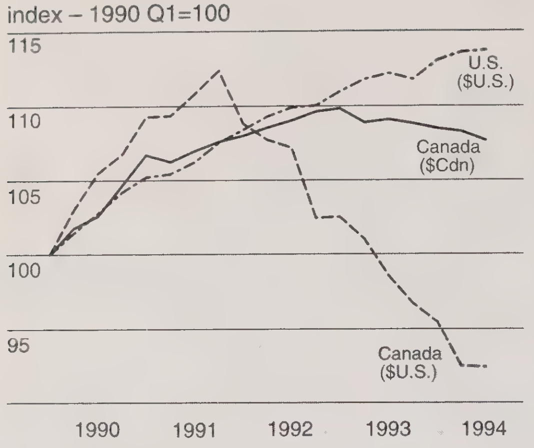
Labour costs, which represent roughly 60% of total production costs, have remained very subdued. Average negotiated wage settlements in the third quarter rose only 0.3% and average compensation per worker actually declined. The decline in average compensation, combined with continued labour productivity increases, led to a 2.1% decline in unit labour costs – its fourth consecutive quarterly decline.

This, coupled with the depreciation of the dollar, has led to continued strong improvements in Canadian competitiveness. This is evident in Chart 3, which shows a substantial fall in Canadian unit labour costs relative to those in the U.S. when both are measured in U.S. dollars (to take account of the Canadian dollar depreciation since mid 1991).

Trade

The trade sector continued to be the primary source of growth in the third quarter in response to the steady improvements in competitiveness. Surging real exports (up 21.4%), combined with a smaller increase in imports (8.3%) and strong terms of trade

Chart 3
Total economy
Unit labour costs



gains, led to a $10.3 billion improvement in the nominal trade balance in the third quarter. This was the largest quarterly improvement ever recorded.

This gain was almost entirely in trade in goods, as the merchandise trade surplus increased $9.4 billion to its highest level in a decade. This improvement was led by a strong gain in net auto exports.

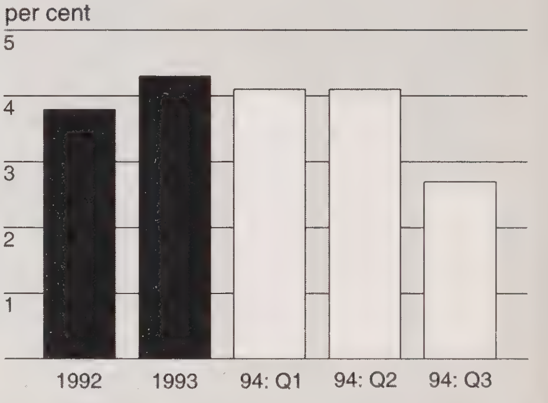
The higher trade surplus lowered the current account deficit $9.7 billion to $20.5 billion dollars in the third quarter, after remaining near $30 billion in the previous six quarters. As a result, the current account deficit fell to 2.7% of GDP, its lowest share in seven years (Chart 4).

Financial markets

After declining about 130 basis points from late June to the end of September, short-term interest rates rebounded about 190 basis points by December 13. Longer term interest rates increased only modestly over this period. Canada-U.S. interest rate spreads on short-term rates were narrow through November, but widened significantly in December.

The Canadian dollar has declined from almost 74 ½ cents U.S at the end of September to about 72 cents U.S. recently.

Chart 4
Current account deficit
as share of GDP



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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE MARCH 1995

KEY MESSAGES

- Real GDP grew 5.9% in the fourth quarter and 4.5% in 1995 for the year as a whole – the best annual growth rate since 1988.
- Growth in the quarter was broadly based, with gains in consumer spending, business investment and international trade all contributing significantly to the expansion.
- Despite the robust growth, domestic cost and price performance remains excellent, reflecting continued declines in unit labour costs.
- After rising sharply late in 1994 and in the first half of January, short-term interest rates have levelled off.

SUMMARY[1]

Growth continued at a rapid pace in the fourth quarter, due to booming exports and strong domestic demand (Chart1). The merchandise trade surplus reached a record level, reflecting strong U.S. demand and ongoing gains in competitiveness. Business investment remained buoyant in response to surging profits and high capacity utilization in export oriented industries. In a break from the past, a sharp rise in consumer expenditure also contributed strongly to growth. Residential investment, however, fell for the second consecutive quarter.

Price and cost performance remained excellent. Strong productivity gains and restrained wage growth resulted in unit labour costs declining for the fifth consecutive quarter at the end of 1994.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data reported in this document is noon, March 10, 1995.

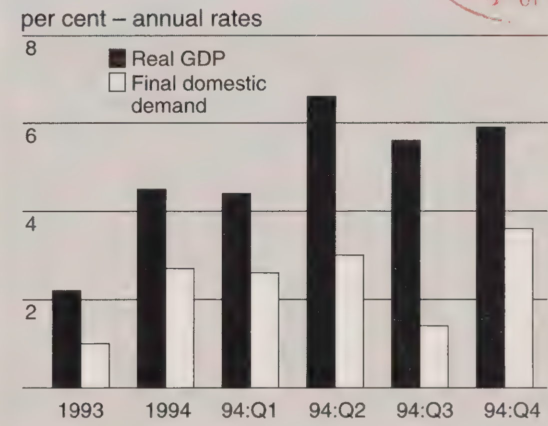
This contributed to a further moderation in inflation, with the GDP deflator (the broadest measure of Canadian inflation) declining marginally in the quarter.

Since the third week of January, short-term interest rates and the value of the Canadian dollar have remained largely unchanged.

Exports booming

Real exports increased 31.8% in the fourth quarter, the 12th consecutive gain and the largest quarterly increase in 11 years. This rise was only partially offset by a 23.5% increase in import volumes. As a result, the merchandise trade surplus reached a record level in the fourth quarter, with international trade accounting for almost half of the increase in real GDP. This excellent trade performance reflects both strong demand in the U.S. and continuing gains in Canadian cost competitiveness.

Chart 1
Real GDP and final domestic demand



Despite the improvement in trade, the current account balance worsened slightly, as rising profits of partially or completely foreign-held enterprises in Canada (which are counted as an income outflow) more than offset the rising trade surplus. Nonetheless, the current account deficit has stabilized in the last two quarters at about 2.8% of GDP, compared to 3.9% or above in the previous six quarters.

Business investment remains strong

Surging profits, declining unit labour costs and high capacity utilization rates in export-oriented industries continue to encourage strong investment spending. Both non-residential construction, and machinery and equipment investment posted sharp increases in the fourth quarter. For the year as a whole, growth in overall business fixed investment, at 7.7%, was the highest since 1988.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1993	1994	1994: Q2	1994: Q3	1994: Q4	Most recent	
Real gross domestic product	2.2	4.5	6.6	5.6	5.9	–	
GDP excluding inventories	1.4	4.3	5.1	6.5	6.8	–	
Final domestic demand	1.0	2.7	3.0	1.4	3.6	–	
Government expenditure	1.0	-1.3	-2.3	-1.3	0.2	–	
Consumer expenditure	1.6	3.1	2.6	2.0	4.6	–	
Residential investment	-4.4	2.9	13.4	-12.8	-3.7	–	
Business fixed investment	0.7	7.7	10.2	10.2	8.6	–	
Non-residential construction	-9.3	5.9	17.3	18.1	7.3	–	
Machinery and equipment	6.2	8.6	7.2	6.8	9.2	–	
Business inventory change[1]	0.8	0.2	1.5	-0.8	-0.8	–	
Trade balance[1]	0.3	1.4	2.0	4.5	2.7	–	
Exports	10.4	14.4	23.6	24.9	31.8	–	
Imports	8.8	9.6	16.2	10.9	23.5	–	
Current account balance	-30.7	-24.8	-29.2	-19.6	-21.5	–	
(percentage of GDP)	-4.3	-3.3	-3.9	-2.6	-2.8	–	
Real personal disposable income	0.8	1.3	3.2	-1.6	1.7	–	
Profits before taxes	20.3	41.4	43.5	41.6	48.0	–	
Costs and prices (%, y/y)							
GDP price deflator	1.1	0.7	0.5	0.9	0.3	–	
Consumer price index	1.8	0.2	0.0	0.2	0.0	0.6	Jan-95
CPI – excluding food and energy	2.0	0.1	0.0	-0.1	-0.2	0.3	Jan-95
Unit labour costs	0.3	-1.3	-0.6	-1.4	-1.7	-0.9	Dec-94
Wage settlements (total)	0.7	0.3	0.2	0.5	0.4	0.4	Dec-94
Labour market							
Unemployment rate	11.2	10.4	10.6	10.2	9.7	9.6	Feb-95
Employment growth (%, a.r.)	1.2	2.1	3.2	3.8	2.7	-1.8	Feb-95
Financial markets (average)							
Exchange rates (average)	77.55	73.24	72.34	72.93	73.12	70.96	9-March
Prime interest rate	5.94	6.88	7.17	7.25	7.33	9.75	9-March

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

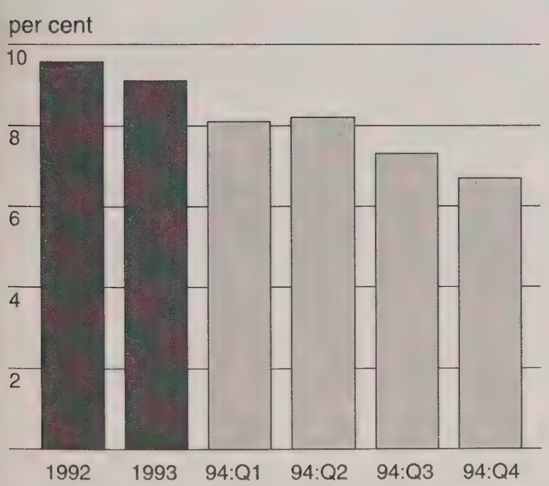
The Preliminary Private and Public Investment (PPI) intentions survey indicates that investment will continue to grow in 1995 but at a slower pace than last year. Nominal business non-residential investment spending is expected to increase 5.0% this year, down from 12.6% in 1994. This slowing in the growth of investment spending is due to a decline in intended non-residential construction (3.0%) spending, while growth in machinery and equipment spending remains high (10.1%).

Household spending strengthens

Real consumer spending growth strengthened noticeably in the fourth quarter to 4.6% from 2.0% in the third. This improvement was more than accounted for by a sharp rebound in durables goods spending. However, sharp declines in motor vehicle sales in January and February suggest that consumer expenditure growth is slowing somewhat in the first quarter.

Over much of the past two years, growth in consumer spending has significantly outstripped that of disposable income. As a result, the savings rate has declined from a recent peak of 10% in the second quarter of 1993 to 6.7% at the end of 1994. This is its lowest level in 23 years (Chart 2).

Chart 2
Personal savings rate



This decline has reflected both a strengthening of consumer confidence and rapid growth of personal wealth relative to income.

Residential investment continued to decline in the fourth quarter, as spending in this area has been adversely affected by the rise in interest rates since early 1994. Further declines in housing starts and sales of existing houses suggest that the weakness in housing investment continued into early 1995.

Strong employment growth continues

A sustained increase in employment this year has been a major factor strengthening consumer confidence, which reached its highest level in five years in the fourth quarter. Since January 1994, employment has increased 413,000, all of which has been in full-time jobs. In November alone, employment increased 95,000, one of the largest monthly gains on record.

This rapid growth in employment, combined with little change in the participation rate, has led to a sharp decline in the unemployment rate to 9.6% in February from 11.4% at the beginning of 1994.

Prices, costs and profitability

The price and cost performance of the Canadian economy continues to be excellent. Unit labour costs, which represent roughly 60% of total production costs in the economy, fell for the fifth consecutive quarter at the end of 1994 and had its first annual decline in 40 years. This has been the result of restrained wage growth and excellent productivity performance, as evident by the gap between wage and unit labour cost growth in Chart 3.

Coupled with the depreciation of the dollar, the decline in unit labour costs has led to a strong improvement in Canadian cost competitiveness since the end of 1991. By the fourth quarter of 1994, Canadian unit labour costs relative to the United States dipped below their previous low in 1986 to reach the best level on record (back to 1950).

The excellent labour cost performance has also allowed domestic price inflation to remain moderate despite surging profits (which nearly doubled in the past nine quarters) and strong price pressures coming from abroad. The external price pressures reflect both the impact of the depreciation of the Canadian dollar and healthy growth in international demand. In spite of these pressures, the broadest measure of inflation for Canadian produced goods and services, the GDP deflator, declined slightly in the fourth quarter and increased only 0.6% in 1994 as a whole – the lowest increase in 33 years.

Financial markets stabilize

The rise in short-term interest rates, that began in early December levelled off in mid January. Over that period, short-term interest rates rose about 2½ percentage points. During this same period, the Canadian dollar depreciated 2½ cents to a low of 70.20 cents U.S.

Short-term interest rates and the exchange rate have since fluctuated in a fairly narrow range. On March 9 the closing value of the Canadian dollar was 70.96 cents U.S. and the 3-month Treasury bill rate was 8.17%.

Chart 3
Growth in unit labour costs and wages

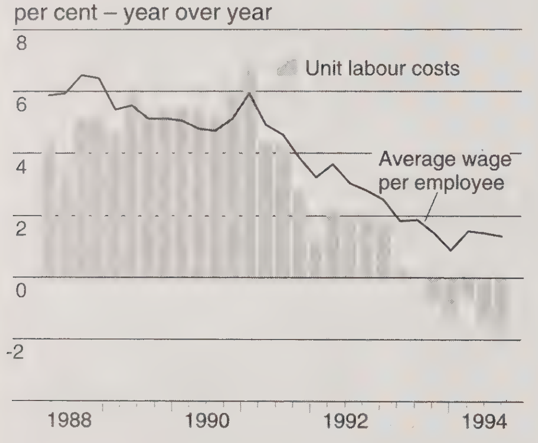
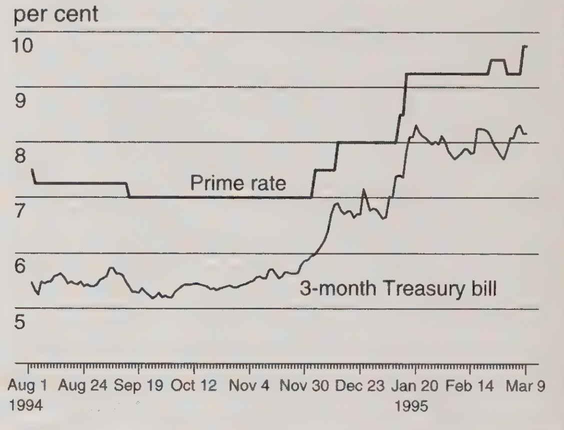


Chart 4
Three-month Treasury bill and the prime rate



The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre (613) 995-2855. For other inquiries about this publication, contact Cliff Halliwell (613) 992-9324.
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THE ECONOMY IN BRIEF

THE DEPARTMENT OF FINANCE JUNE 1995

KEY MESSAGES

- Real GDP growth slowed noticeably to 0.7% in the first quarter, the slowest pace since the fourth quarter of 1992. This follows growth of 4.6% in the fourth quarter and for 1994 as a whole. A sharp decline in demand was more than offset by a large inventory accumulation.
- The slowing reflects the impacts of both a slowing of growth in the U.S. and a sharp decline in demand in the interest-sensitive sectors of the economy.
- The slowing in growth and a stabilizing of the Canadian dollar has led to an easing of both short- and long-term interest rates.

SUMMARY[1]

Growth in both output and employment slowed noticeably in the first quarter (Chart 1), reflecting a widespread weakening in demand. Demand in interest-sensitive sectors, such as residential investment, consumer durables and business non-residential construction, declined sharply, pulling down final domestic demand. As well, the real merchandise trade surplus fell sharply, as growth in foreign demand weakened. Offsetting this drop in demand was a large inventory accumulation. One bright spot was the continued buoyancy in machinery and equipment investment in response to profit gains and high capacity utilization in export-oriented industries.

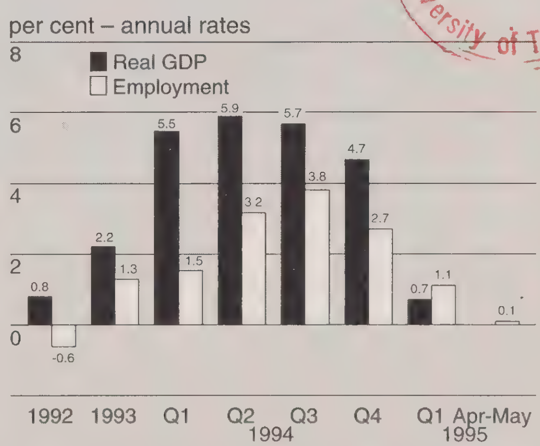
Wage settlements and growth in average wages remained subdued. However, unit labour costs posted a modest gain for the first time in nine quarters, a reflection of the sharp slowdown in GDP growth, which resulted in a slight drop in productivity (GDP per employee). A sharp rise in the GDP deflator (the broadest measure of inflation) in the first quarter largely reflected the impact on export prices of rising world commodity prices and the depreciation of the Canadian dollar.

Since the end of March, short- and long-term interest rates have fallen significantly while the value of the Canadian dollar has stabilized.

Employment growth stalls

While employment has continued to grow in the private sector over the last six months, employment in the public sector has shrunk (Chart 2). The result is that only 8,000 net new jobs were created between November and May. This stall in total employment growth was a factor behind a weakening in consumer confidence in the quarter.

Chart 1
Real GDP and employment



*Average of April and May employment relative to the first quarter average.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data reported in this document is noon, June 14, 1995.

With slow employment growth and the labour force declining slightly due to a continuation of a downward trend in the participation rate, the unemployment rate has been relatively stable for the last half year. It was 9.5% in May.

Household spending slows

At 0.2% in the first quarter, real consumer spending growth was at its slowest rate since the first quarter of 1992. This stands in sharp contrast to the 3.9% pace of the fourth quarter. This slowdown largely reflected a sharp drop in spending on durable goods, notably on automotive products. Motor vehicle sales continued their sharp decline in April and, despite a rebound in May, average sales in those two months were well below first quarter levels. This suggests consumer expenditure growth will remain slow in the second quarter.

During 1994, as employment rose and consumers gained confidence, households made extensive use of credit to finance their purchases and the personal savings rate dropped. Consumers retrenched in

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1993	1994	1994: Q3	1994: Q4	1995: Q1	Most recent	
Real gross domestic product	2.2	4.6	5.7	4.6	0.7	–	
GDP excluding inventories	1.4	4.3	6.5	5.1	-3.2	–	
Final domestic demand	1.1	2.9	0.9	3.8	-0.4	–	
Government expenditure	0.5	-0.8	1.7	1.5	-0.5	–	
Consumer expenditure	1.6	3.0	1.6	3.9	0.2	–	
Residential investment	-4.2	3.0	-18.9	-11.9	-15.3	–	
Business fixed investment	2.7	9.4	5.7	14.2	3.1	–	
Non-residential construction	0.5	5.2	4.3	10.5	-11.9	–	
Machinery and equipment	3.9	11.6	6.4	16.0	11.3	–	
Business inventory change[1]	0.9	0.3	-0.8	-0.4	3.9	–	
Trade balance[1]	0.3	1.1	5.0	1.8	-2.2	–	
Exports	10.4	14.2	25.5	30.7	5.3	–	
Imports	8.8	10.5	10.0	25.0	11.2	–	
Current account balance	-28.8	-22.3	-17.9	-15.8	-15.8	–	
(percentage of GDP)	-4.0	-3.0	-2.4	-2.1	-2.0	–	
Real personal disposable income	0.4	1.1	-0.3	3.0	4.5	–	
Profits before taxes	20.2	36.1	34.3	27.5	12.4	–	
Costs and prices (%, y/y)							
GDP price deflator	1.1	0.6	0.8	0.5	1.6	–	
Consumer price index	1.8	0.2	0.2	0.0	1.6	2.5	Apr-95
CPI – excluding food and energy	2.0	0.1	-0.1	-0.2	1.3	2.2	Apr-95
Unit labour costs	-0.5	-1.4	-1.5	-1.1	-0.1	–	
Wage settlements (total)	0.6	0.3	0.5	0.4	0.8	–	
Labour market							
Unemployment rate	11.2	10.4	10.2	9.7	9.7	9.5	May-95
Employment growth (%, a.r.)	1.3	2.1	3.8	2.7	1.1	0.0	May-95
Financial markets (average)							
Exchange rates (average)	77.55	73.24	72.93	73.12	71.08	72.57	9-Jun-95
Prime interest rate	5.94	6.88	7.25	7.33	9.50	9.00	9-Jun-95

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

the first quarter. As employment growth stalled and interst rates rose, consumer credit borrowing declined sharply and the personal savings rate increased to 8.3% from 7.4%.

Residential investment continued its sharp decline for the third consecutive quarter. This weakness can largely be attributed to high real mortgage rates and the decline in consumer confidence. Housing activity has continued to weaken in the second quarter, with housing starts and existing house resales both reaching their lowest levels since the 1981-1982 recession.

Current account balance unchanged

In the first quarter, real exports rose for the 13th consecutive quarter but at a much slower pace than last year. This rise in exports was more than offset by increasing import volumes. As a result, the real merchandise trade surplus fell sharply, subtracting substantially from real growth. The sharp weakening in export growth reflected a slowing in U.S. growth, especially U.S. demand for automotive products, and to some extent the Canadian rail and port strikes in March.

Despite the deterioration in real merchandise trade flows, the current account deficit was unchanged from its fourth quarter level. With export prices rising faster than import prices, the gain in the terms of trade raised the nominal merchandise trade surplus to a new record high. This, plus an improved travel account, offset a deterioration in the net international investment income deficit. The latter resulted as increases in interest rates boosted interest payments to non-residents. As a result, the current account deficit in the last two quarters stood at about 2.0% of nominal GDP, half its 1993 level (Chart 3).

Chart 3
Current account deficit as share of GDP

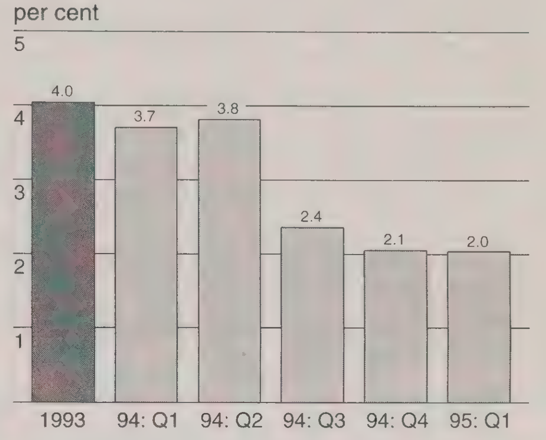
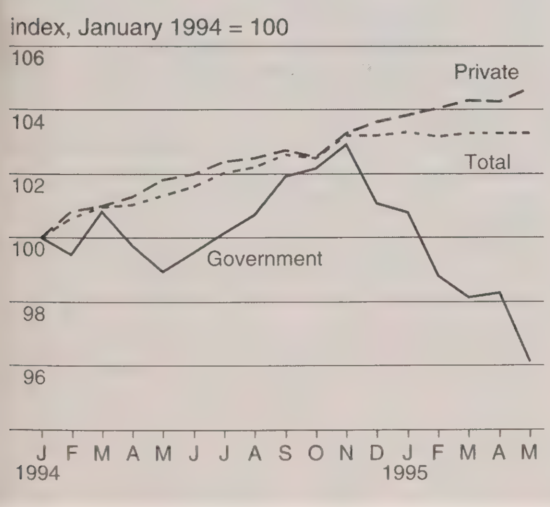


Chart 2
Employment growth by sector



Inventory accumulation increases sharply

The unexpected weakening in demand in the quarter led to the largest quarterly increase in business inventories in almost seven years. This accumulation was broadly based, including manufacturers, retailers and wholesalers. A significant portion was in automotive inventories, the result of the sharp decline in sales in North America. The increase in inventory investment was equivalent to 0.9% of GDP.

Business investment remains strong

Subdued unit labour cost growth and high capacity utilization rates continue to encourage investment spending. In the first quarter, however, this was limited to machinery and equipment investment, as non-residential construction posted a sharp decline.

The investment performance in the first quarter was consistent with the Preliminary Private and Public Investment (PPI) intentions survey. That survey indicated nominal machinery and equipment spending was expected to rise sharply in 1995 while nominal non-residential construction spending was expected to decline significantly.

Prices, costs and profitability

The domestic cost performance of the Canadian economy remained excellent since wage growth continued to be restrained. While unit labour costs, which represent roughly 60% of total production costs in the economy, did rise in the first quarter, this largely reflected the impact of the sharp slowdown in GDP growth on labour productivity rather than a pickup in wage increases.

Despite this good underlying domestic cost performance, inflation as measured by the CPI has increased. This is largely due to rising world commodity prices and increased import costs. The latter reflects the depreciation of the Canadian dollar. These are not expected, however, to be a source of ongoing inflationary pressure.

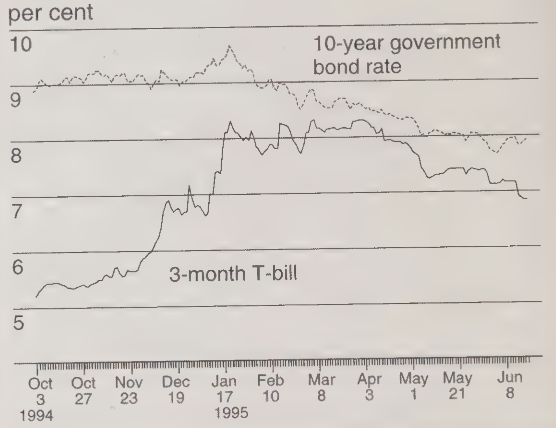
The restrained domestic cost performance, along with a longer term depreciation of the dollar, has led to a strong improvement in Canadian cost competitiveness since the end of 1991. Canadian unit labour costs relative to those in the United States are below their previous low in 1986 and at their best level on record (back to 1950).

Financial markets stabilize

The decline in interest rates that began after the budget has continued into June. Since early April, short-term interest rates have fallen about 140 basis points while long-term rates have dropped about 70 basis points. The value of the Canadian dollar has stabilized relative to its U.S. counterpart, trading between 72 and 74 cents U.S.

On June 13, the closing value of the Canadian dollar was 72.33 cents U.S. and the three-month Treasury bill rate was 6.91%.

Chart 4
Three-month Treasury bill and the 10-year government bond rate



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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE

SEPTEMBER 1995

KEY MESSAGES

- Real GDP fell 1.0% in the second quarter, the first decline since the first quarter of 1991. This follows a slowing in growth to 0.9% in the first quarter from 4.6% in the fourth quarter and for 1994 as a whole. A second consecutive large inventory accumulation prevented a larger decline in GDP.
- This weakness reflects the impacts of both slow growth in the U.S. and a continued sharp decline in demand in the interest-sensitive sectors of the economy.
- The slowing in growth and a modest strengthening of the Canadian dollar has led to an easing of both short- and long-term interest rates since April.

SUMMARY[1]

Output fell and employment gains slowed substantially in the second quarter (Chart 1), a reflection of a widespread weakening in demand. Demand in interest-sensitive sectors, such as residential investment, consumer durables and business non-residential construction, declined sharply. However, buoyant machinery and equipment investment was again a bright spot, responding to a continuing solid profit picture, despite a decline in the second quarter. Also, growth in consumer spending on services rose. As a result, final domestic demand showed almost no growth in the first half of the year. With weak foreign demand producing a decline in the real merchandise trade surplus, GDP fell. Only an inventory accumulation even greater than in the first quarter prevented a larger decline in production.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data reported in this document is noon, September 8, 1995.

Wage settlements and growth in average wages remained subdued. However, unit labour costs posted another modest gain, a reflection of a cyclical productivity (GDP per employee) loss from the drop in output.

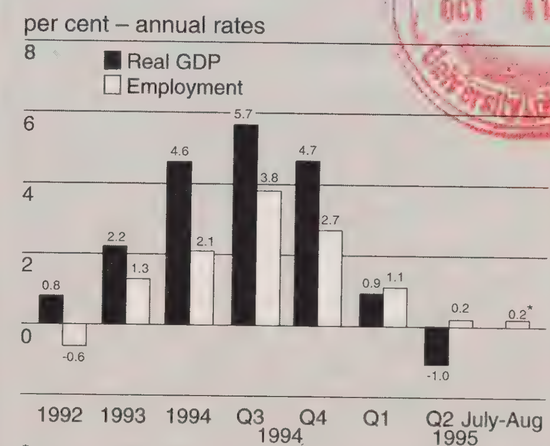
Since the end of March, short- and long-term interest rates have fallen while the value of the Canadian dollar has risen somewhat.

Employment growth remains slow

While employment has continued to grow strongly in the private sector over the last nine months (2.8% at annual rates), in the public sector it has shrunk (Chart 2). The result is that only 33,000 net new jobs were created between November and August. This slowing in total employment growth was an important factor behind the fall in consumer confidence in the first half of the year.

With net employment growth very moderate and the labour force rising modestly due to growth in the working age population, the unemployment

Chart 1
Real GDP and employment



*Average of July and August employment relative to the second quarter average.

rate has been relatively stable during this period. It was 9.6% in August, the same as in November 1994.

Household spending growth remains slow

Real consumer spending increased a modest 0.9% in the second quarter. Growth in spending on consumer services picked up but spending on goods actually declined. The latter largely reflected a significant decline in spending on durables, notably on furniture and household appliances and automotive products. Spending on non-durables also weakened.

Indications are that consumer expenditure growth will continue in the third quarter. While department store sales weakened in July, they remained above the second quarter average. Also, average motor vehicle sales in July and August were noticeably above average sales in the second quarter.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1993	1994	1994: Q4	1995: Q1	1995: Q2	Most recent	
Real gross domestic product	2.2	4.6	4.6	0.9	-1.0	–	
GDP excluding inventories	1.4	4.3	5.1	-2.5	-1.4	–	
Final domestic demand	1.1	2.9	3.8	-0.2	0.4	–	
Government expenditure	0.5	-0.8	1.5	0.9	-2.2	–	
Consumer expenditure	1.6	3.0	3.9	0.1	0.9	–	
Residential investment	-4.2	3.0	-11.9	-16.1	-15.2	–	
Business fixed investment	2.7	9.4	14.2	3.2	8.8	–	
Non-residential construction	0.5	5.2	10.5	-9.9	-9.2	–	
Machinery and equipment	3.9	11.6	16.0	10.2	18.2	–	
Business inventory change[1]	0.9	0.3	-0.4	3.5	0.3	–	
Trade balance[1]	0.3	1.1	1.8	-2.1	-2.5	–	
Exports	10.4	14.2	30.7	4.6	-13.0	–	
Imports	8.8	10.5	25.0	10.2	-7.3	–	
Current account balance (nominal)	-28.8	-22.3	-15.8	-19.1	-22.1	–	
(percentage of GDP)	-4.0	-3.0	-2.1	-2.5	-2.8	–	
Real personal disposable income	0.4	1.1	3.0	5.4	-2.0	–	
Profits before taxes	20.2	36.1	27.5	14.6	-10.9	–	
Costs and prices (%, y/y)							
GDP price deflator	1.1	0.6	0.5	1.4	1.9	–	
Consumer price index	1.8	0.2	0.0	1.6	2.7	2.5	Jul 95
CPI – excluding food and energy	2.0	0.1	-0.2	1.3	2.5	2.6	Jul 95
Unit labour costs	-0.5	-1.5	-1.2	-0.3	0.4	1.4	Jun 95
Wage settlements (total)	0.6	0.3	0.4	0.8	1.0	0.9	Jun 95
Labour market							
Unemployment rate	11.2	10.4	9.7	9.7	9.5	9.6	Aug 95
Employment growth (%, a.r.)	1.3	2.1	2.7	1.1	0.2	2.5	Aug 95
Financial markets (average)							
Exchange rates (average)	77.55	73.24	73.12	71.08	72.93	74.52	Sep 7
Prime interest rate	5.94	6.88	7.33	9.50	9.25	8.00	Sep 7

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Despite the very modest growth in consumer spending in the second quarter, the personal savings rate fell from 8.5% in the first quarter to 7.7% in the second. This reflected a substantial slowing in the growth rate of disposable income due to slower growth in wages and salaries and a rebound in income tax payments.

In the second quarter, residential investment declined sharply for the fourth consecutive quarter. This can be largely attributed to high real mortgage rates and lower consumer confidence. Housing starts were down sharply, even from their low levels in the first quarter. This weakening continued into July, when starts reached their lowest level since during the 1981-1982 recession. One bright spot, however, was a surge in existing house resales after having reached their lowest level since the end of 1984 in April. Unit sales surged about 70% in the quarter. While declining slightly in July, resales did remain above their second quarter average.

Large inventory accumulation again

The decline in output would have been more substantial except for a second consecutive large increase in inventory stocks, yielding the second largest two-quarter accumulation on record (Chart 3). This accumulation was broadly based, including manufacturers, retailers and wholesalers. Since the accumulation in the second quarter was only slightly larger than that in the first, inventory investment added marginally to growth.

Chart 2
Change in employment since November 1994

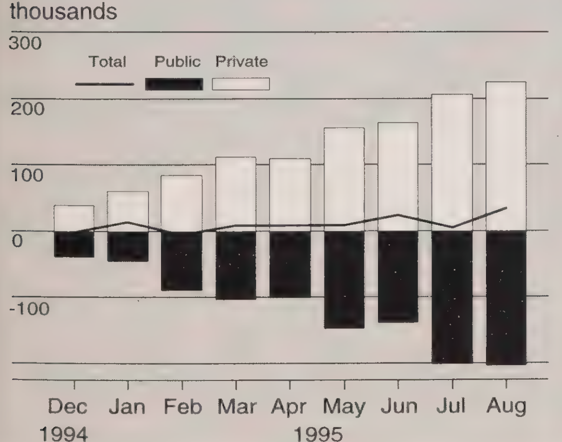
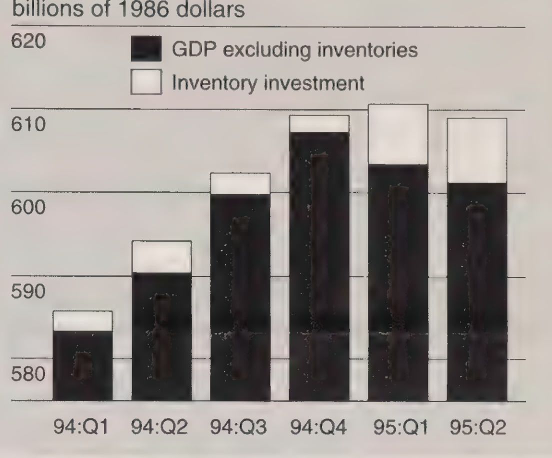


Chart 3
Real GDP including and excluding inventory investment



Business investment remains strong

In the second quarter, high capacity utilization rates continued to encourage investment spending. However, as in the first quarter, this was limited to machinery and equipment investment, as non-residential construction posted a sharp decline.

The mid-year Private and Public Investment (PPI) intentions survey indicated businesses have revised up their capital expenditure intentions for 1995 relative to the preliminary survey. The strong growth originally expected for nominal spending on machinery and equipment strengthened to 10.9% while the small decline expected in nominal spending on non-residential construction was revised to a 3.1% increase. However, when likely price increases are taken into account, this still implies reduced real investment in 1995 in non-residential construction, as is evident to date.

Current account worsens somewhat

In the second quarter, real exports fell for the first time since the fourth quarter of 1991. This loss in demand was only partly offset by declining import volumes. As a result, the real merchandise trade surplus fell, subtracting noticeably from total output.

The decline in exports reflected slowing growth in the U.S., particularly in the demand for automotive and industrial products. The smaller decline in imports can be largely traced to imports of machinery and equipment for Hibernia.

The lower trade surplus was almost entirely responsible for a deterioration in the current account, as net international investment income payments were virtually unchanged. Lower dividend payments to non-residents were offset by increased retained earnings on foreign investments in Canada. As a result, the current account deficit stood at 2.8% of nominal GDP in the second quarter, up from mid-1994 but still well below the 1993 average of 4.0%.

Prices, costs and profitability

The domestic cost performance of the Canadian economy remained excellent as wage growth continued to be restrained. Unit labour costs, which represent roughly 60% of total production costs in the economy, did rise again in the second quarter, but this largely reflected the impact of the cyclical decline in output on labour productivity. Wage settlements remained subdued.

This good underlying domestic cost performance helped contain inflationary pressures, permitting the profit to GDP ratio to remain at its third highest level since 1989 despite a decline in the second quarter. The inflation rate, as measured by the CPI, had been rising due largely to rising world commodity prices and increased import costs. The latter reflected the earlier depreciation of the dollar. As expected, these have not proven to be a source of ongoing inflationary pressure. With commodity prices no longer rising and the dollar stabilizing, the rate of inflation has once again begun to decline.

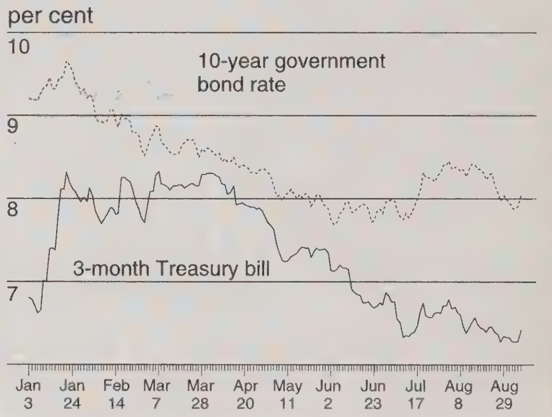
Interest rates decline

The drop in short-term interest rates, which began after the Budget, continued into August. Since early April, short rates have fallen about 190 basis points. Long-term rates began to decline earlier in 1995 than did short rates and have fallen about 160 basis points from their 1995 peak. However, in recent months they have fluctuated, with their decline since early April equalling about 50 basis points.

The value of the Canadian dollar has risen recently relative to its U.S. counterpart. After trading in the 72 to 74 cents U.S. range for some time, it appreciated noticeably in August, reaching values last seen in early 1994.

On September 7, the closing value of the Canadian dollar was 74.52 cents U.S. and the 3-month Treasury bill rate was 6.42%.

Chart 4
3-month Treasury bill and the 10-year government bond rate



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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE | DECEMBER 1995

KEY MESSAGES

- Real GDP rose 2.1% in the third quarter, following a decline of 0.6% in the second. This rebound was largely due to strong export growth, reflecting a strengthening in the U.S. economy.
- Final domestic demand remained largely unchanged for the third consecutive quarter.
- Since the Quebec referendum, the downward trend evident throughout much of 1995 in both short- and long-term interest rates has resumed.

SUMMARY[1]

The growth of both output and employment increased in the third quarter. Increased foreign demand, notably from the U.S., was the primary source of this gain. This was partly offset by a slight decline in final domestic demand and a smaller inventory accumulation than in the previous quarter.

Domestic demand continued the weakness evident throughout 1995 (Chart 1). In the third quarter, declines in government spending, machinery and equipment investment and residential investment more than offset growth in consumer spending. Inventory investment also declined from the elevated levels in the first half of the year.

Wage settlements and growth in average wages remained subdued. A modest productivity (GDP per employee) gain, combined with continuing low wage increases, allowed unit labour costs to remain unchanged and inflation under control.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data reported in this document is noon, December 7, 1995.

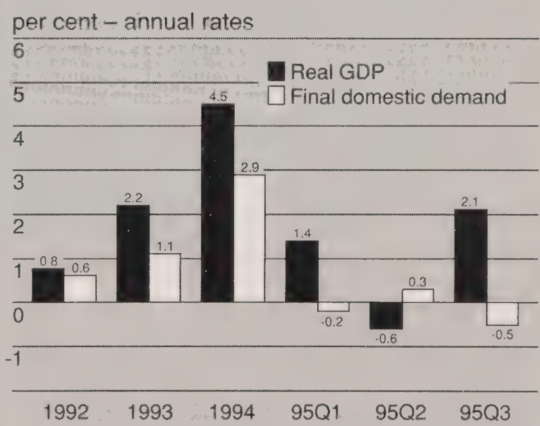
Household spending picks up

Slow employment growth has restrained consumer confidence during 1995. Nonetheless, real consumer spending increased 2.5% in the third quarter, a much stronger gain than in each of the first two quarters of the year. The improvement, however, was concentrated in spending on automotive products. Spending growth on other goods and services was modest.

The growth in consumer spending occurred despite a drop in disposable income due to higher income-tax payments. As a result, the personal savings rate fell from 7.5% in the second quarter to 6.3% in the third, the lowest savings rate in nearly 24 years (Chart 2).

Stronger growth in spending than in income, as reflected by the declining savings rate over the last three years, has been supported by continuing growth in household wealth. At the end of 1994, net real wealth per household was at its highest level ever.

Chart 1
Real GDP and final domestic demand



In the third quarter, residential investment fell sharply for the fifth consecutive quarter. This can be largely attributed to the continuation of high real mortgage rates and weak consumer confidence. Housing starts have weakened throughout much of the year and in October fell to their lowest level since the 1981-1982 recession. However, existing house resales surged again in the third quarter, with unit sales rising about 95% after having risen about 70% in the second.

Smaller inventory accumulation

Output growth was slowed by a decline in the rate of accumulation of inventories from the unusually high levels in the previous two quarters. However, the inventory-to-sales ratio did increase again in the third quarter, but at a slower pace than in the previous two quarters.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1993	1994	1995: Q1	1995: Q2	1995: Q3	Most recent	
Real gross domestic product	2.2	4.6	1.4	-0.6	2.1	–	
GDP excluding inventories	1.4	4.3	-1.8	-0.9	3.2	–	
Final domestic demand	1.1	2.9	-0.2	0.3	-0.5	–	
Government expenditure	0.5	-0.8	0.8	-2.4	-4.1	–	
Consumer expenditure	1.6	3.0	0.1	0.9	2.5	–	
Residential investment	-4.2	3.0	-18.4	-13.6	-5.3	–	
Business fixed investment	2.7	9.4	4.7	7.4	-5.7	–	
Non-residential construction	0.5	5.2	-3.5	-16.2	0.8	–	
Machinery and equipment	3.9	11.6	8.9	20.5	-8.4	–	
Business inventory change[1]	0.9	0.3	3.2	0.3	-1.1	–	
Trade balance[1]	0.3	1.1	-1.0	-2.2	3.6	–	
Exports	10.4	14.2	7.1	-10.5	9.9	–	
Imports	8.8	10.5	9.9	-5.5	0.8	–	
Current account balance (nominal)	-28.8	-22.3	-19.0	-19.0	-13.6	–	
(percentage of GDP)	-4.0	-3.0	-2.5	-2.4	-1.7	–	
Real personal disposable income	0.4	1.1	3.9	-0.9	-2.6	–	
Profits before taxes	20.2	36.1	16.5	-9.2	24.0	–	
Costs and Prices (%, y/y)							
GDP price deflator	1.1	0.6	1.3	1.8	1.8	–	
Consumer price index	1.8	0.2	1.6	2.7	2.4	2.4	Oct 95
CPI – excluding food and energy	2.0	0.1	1.3	2.5	2.7	2.6	Oct 95
Unit labour costs	-0.5	-1.5	-0.4	0.2	0.6		
Wage settlements (total)	0.6	0.3	0.8	1.1	0.9	0.6	Sep 95
Labour market							
Unemployment rate	11.2	10.4	9.7	9.5	9.5	9.4	Nov 95
Employment growth (%, a.r.)	1.3	2.1	1.1	0.2	0.6	-3.8	Nov 95
Financial markets (average)							
Exchange rates (average)	77.55	73.24	71.08	72.93	73.77	73.27	Dec 6/95
Prime interest rate	5.94	6.88	9.50	9.25	8.08	7.75	Dec 6/95

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Business investment declines

In the third quarter, business investment fell. Unlike in previous quarters, the decline was in machinery and equipment investment, as non-residential construction posted a small gain. The drop in machinery and equipment, however, reflected a return to a more normal level of investment. In the second quarter, investment related to the Hibernia offshore oil project came on stream and several commercial aircraft were purchased, boosting such investment to an unusually high level.

Current account improves significantly

The real trade surplus increased substantially in the third quarter. Real exports increased sharply, reflecting stronger economic growth in the U.S. and the significant improvement in Canada's competitive cost position in recent years. In contrast, real imports barely rose, reflecting the weakness in Canadian domestic demand and a return to more normal levels of imported machinery and equipment, following the unusual increases in the second quarter noted above.

Further, with import prices falling more than export prices, the overall nominal trade balance rose sharply, to a record level. This gain more than accounted for a substantial improvement in the current account deficit from $19 billion in the second quarter to $13.6 billion in the third (Chart 3). As a share of nominal GDP, the current account deficit stood at 1.7%, its lowest point in 10 years.

Chart 2
Personal savings rate

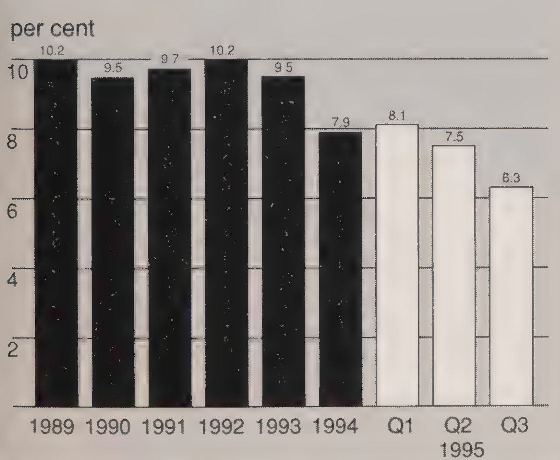
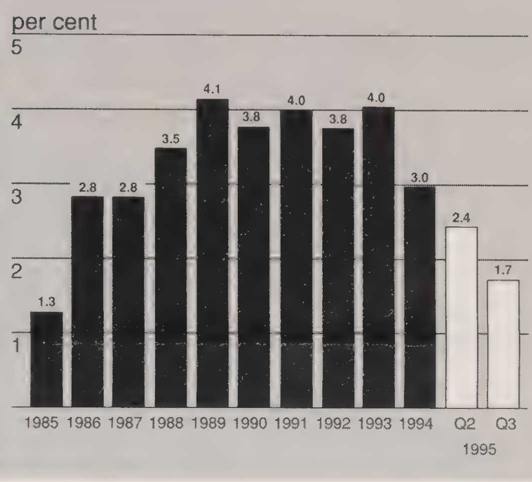


Chart 3
Current account deficit as a share of GDP



Prices, costs and profitability

GDP inflation (the broadest measure of inflation) fell to 1.6% in the third quarter from 2.9% in the second. Most of this drop resulted from a compositional shift toward products with slower price increases. Domestic cost performance remained excellent. Wage settlements and wage growth remained restrained while labour productivity growth revived. As a result, unit labour costs, which represent roughly 60% of total production costs in the economy, were unchanged in the third quarter, after slight increases in the previous two quarters. This helped push the share of corporate profits in GDP to its highest level since the third quarter of 1989.

Employment growth remains slow

While employment growth rose somewhat in the third quarter, it remained well below the pace set in 1993 and 1994. The weakness evident during the last year has continued into the fourth quarter, as a decline in November partly offset earlier gains.

In the 12 months from November 1994 to November 1995, about 40,000 net new jobs were created, a dramatic slowdown from the nearly 400,000 jobs created in the 12-month period prior to that. Much of this slowdown reflects declines in the public sector. In the last 12 months, about 170,000 net new jobs were created in the private sector while over 130,000 jobs were cut from the public sector.

Labour force growth also has been stagnant over the past year. An almost continuous decline in the participation rate to its lowest level in 15 years in November offset growth in the working-age population. This has kept the unemployment rate relatively stable during the last 12 months, despite the very modest growth in employment. In November, it was 9.4%.

Fourth quarter indicators

Early indications for the fourth quarter are mixed. Average employment in October and November was above that in the third quarter. Further, retail sales and GDP at factor cost in September were both above their third quarter averages. Other indicators, however, are less positive. Housing starts, housing resales and motor vehicle sales all declined in October.

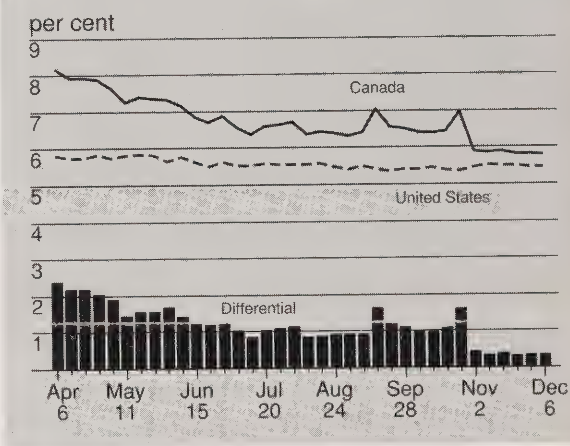
Interest rates decline

Monetary conditions have eased since early 1995, reflecting the continuous weakness of the economy, the excellent cost and price performance in Canada and the fiscal restraint being applied by the federal and most provincial governments. Since early April, short rates have fallen about 250 basis points. As a result, over that time, the spread between short rates in Canada and the U.S. has narrowed from about 250 basis points to about 35 basis points (Chart 4). It has been a year since spreads were this narrow. Long-term rates began to decline earlier in 1995 than did short rates and also have fallen about 250 basis points from their 1995 peak. Despite these declines, interest rates remain at high levels relative to Canada's low inflation rate.

In recent months, there has been some volatility in financial markets associated with the Quebec referendum at the end of October. In the three-week period leading up to the referendum, the Canadian dollar lost about 1.7 cents U.S. in value while short-term interest rates rose about 75 basis points. Immediately after the vote, the economic fundamentals reasserted themselves and short-term interest rates fell about 100 basis points and the dollar strengthened. However, the value of the dollar has since declined back to near the levels in the immediate pre-referendum period.

On December 6, the 3-month Treasury bill rate was 5.79% and the closing value of the Canadian dollar was 73.27 cents U.S.

Chart 4
Canada-U.S. 3-month Treasury bill rates



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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE

MARCH 1996

KEY MESSAGES

- External trade continued to be the major source of growth in the fourth quarter of 1995, helping push the current account deficit down to its lowest level as a share of GDP in a decade. Final domestic demand, however, remained weak, with the result that real GDP increased only 0.8% in the fourth quarter and 2.2% for the year as a whole.
- Until recently, Canadian interest rates had been falling noticeably, virtually eliminating the spread in short-term rates with the U.S. However, in response to much stronger than expected job growth in the U.S. in February, U.S. rates jumped in early March, pulling Canadian rates with them. Nevertheless, interest rates remain well below their levels of a year ago.
- Recent strong gains in employment suggest that growth is strengthening in early 1996.

SUMMARY[1]

Output growth was weak for the fourth consecutive quarter, with external trade continuing to be the primary source of growth. Domestic demand remained weak (Chart 1), as a sharp rise in machinery and equipment investment was largely offset by declines in most other major categories of domestic demand. Also, a decline in inventory investment again slowed economic activity.

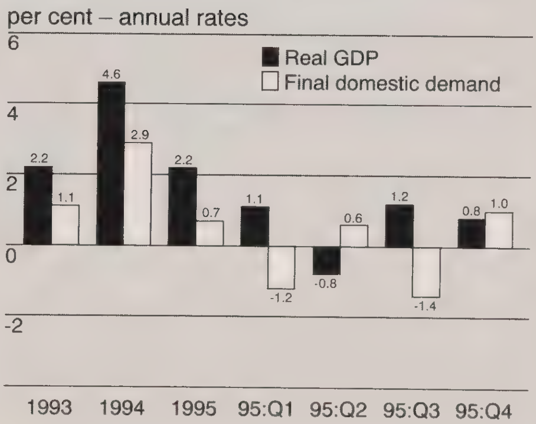
Domestic cost pressures remained subdued, whether measured by wage settlements, growth in average wages, or unit labour costs. This, combined with the weak state of the economy and declines in export prices, reduced growth in the GDP deflator (the broadest measure of inflation for Canadian-made products) from nearly 3% in the second quarter to 0.6% in the fourth.

The weak economy and waning inflation pressures have permitted a substantial easing in monetary conditions, with interest rates down sharply since early 1995.

Household spending falls slightly

Real consumer spending decreased 0.4% in the fourth quarter. Purchases of durable goods, such as automotive products and furniture, and semi-durables fell noticeably, as consumer confidence fell to its lowest level outside of actual recessions. This was partially offset by modest spending growth on non-durable goods and services.

Chart 1
Real GDP and final domestic demand



[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data reported in this document is noon, March 11, 1996.

The drop in consumer spending, combined with a modest gain in disposable income, resulted in the personal savings rate rebounding to 7.0% in the fourth quarter from 6.5% in the third, when it was at its lowest level in the last 24 years.

In the quarter, residential investment registered its sixth consecutive decline despite a modest rebound in new-home construction. Home resales and alterations and improvements both dropped sharply. This can be largely attributed to weak consumer confidence and the continuation of high real mortgage rates, as house prices have been declining.

Smaller inventory accumulation again

Economic activity was slowed for the second consecutive quarter by a decline in the rate of inventory accumulation from the unsustainably

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1994	1995	1995: Q2	1995: Q3	1995: Q4	Most recent	
Real gross domestic product	4.6	2.2	-0.8	1.2	0.8	–	
GDP excluding inventories	4.3	1.8	-1.0	2.7	2.6	–	
Final domestic demand	2.9	0.7	0.6	-1.4	1.0	–	
Government expenditure	-0.8	-0.4	-2.3	-4.4	-0.3	–	
Consumer expenditure	3.0	1.4	1.2	2.4	-0.4	–	
Residential investment	3.0	-13.8	-15.7	-7.7	-6.5	–	
Business fixed investment	9.4	5.2	9.2	-10.1	12.0	–	
Non-residential construction	5.2	-4.5	-20.7	-6.2	-7.0	–	
Machinery and equipment	11.6	10.1	26.2	-11.7	21.1	–	
Business inventory change[1]	0.3	0.4	0.2	-1.4	-1.7	–	
Trade balance[1]	1.1	1.0	-2.2	4.0	1.5	–	
Exports	14.2	11.8	-11.1	12.8	13.9	–	
Imports	10.5	9.0	-6.0	2.5	10.1	–	
Current account balance (nominal)	-22.3	-13.1	-18.9	-10.3	-5.1	–	
(percentage of GDP)	-3.0	-1.7	-2.4	-1.3	-0.6	–	
Real personal disposable income	1.1	1.2	-1.3	-1.8	1.5	–	
Profits before taxes	36.1	14.8	-7.5	3.0	-2.5	–	
Costs and prices (%, y/y)							
GDP price deflator	0.6	1.8	1.8	1.9	1.9	–	
Consumer price index	0.2	2.1	2.7	2.4	2.1	1.6	Jan 96
CPI – excluding food and energy	0.1	2.2	2.5	2.7	2.3	1.7	Jan 96
Unit labour costs	-1.5	0.7	0.3	1.1	1.6	–	
Wage settlements (total)	0.3	0.9	1.1	0.9	0.7	0.6	Dec 95
Labour market							
Unemployment rate	10.4	9.5	9.5	9.5	9.4	9.6	Feb 96
Employment growth (%, a.r.)	2.1	1.6	0.5	0.6	1.1	3.9	Feb 96
Financial markets (average)							
Exchange rates (average)	73.24	72.88	72.93	73.77	73.75	73.09	Mar 8/96
Prime interest rate	6.88	8.65	9.25	8.08	7.75	7.00	Mar 8/96

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada and the Bank of Canada.

Chart 2
Real GDP: Including & excluding inventory investment

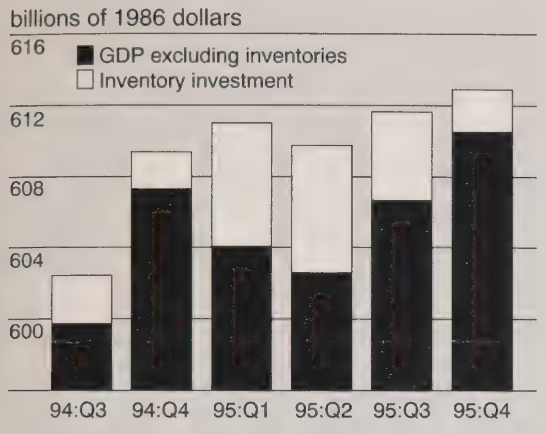
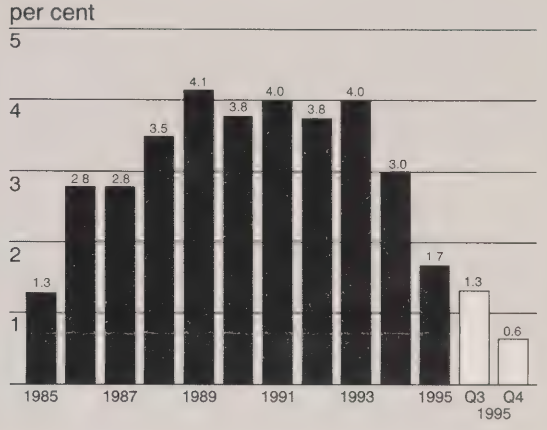


Chart 3
Current account deficit as a share of GDP



high levels earlier in the year (Chart 2). After significant increases at the beginning of 1995, this stabilized the economy-wide inventory-to-sales ratio at a level slightly above its 1994 average, when it was at a record low.

Business investment rises

In the fourth quarter, business investment returned to the pattern evident throughout much of 1995, with healthy growth in machinery and equipment investment and significant declines in non-residential construction. For the year as a whole, machinery and equipment investment was up about 10% with the strength most evident in office equipment. Non-residential construction was a source of weakness throughout 1995, declining 4.5% for the year as a whole. The weakness was largely in engineering projects (bridges, roads, etc.).

The preliminary 1996 Private and Public Investments Intentions Survey suggests this pattern of business investment will continue in 1996, with nominal machinery and equipment investment rising slightly and non-residential construction declining substantially.

Current account improves sharply again

A stronger increase in exports than imports, despite slower growth in the U.S., raised the real trade surplus substantially again in the fourth quarter. This reflected the significant improvement in Canada's cost competitiveness in recent years.

With import prices falling more than export prices, the merchandise and overall nominal trade balances both rose to record levels in the quarter and for 1995 as a whole. This gain largely accounted for a halving of the current account deficit from $10.3 billion in the third quarter to $5.1 billion in the fourth (Chart 3). As a share of nominal GDP, the current account deficit stood at 0.6%, its lowest point in over 10 years.

Prices, costs and profitability

Domestic cost performance remained good. Average wage settlements in the fourth quarter were 0.7%. Unit labour costs rose modestly for the fourth consecutive quarter, but remained below their 1992 level.

As well, weak economic demand and a compositional shift toward goods and services with slower price increases reduced growth in the GDP deflator (the broadest measure of inflation for

Canadian-made products) to 0.6% at annual rates in the fourth quarter from 1.9% in the third. In particular, export prices actually fell about 1% at an annual rate.

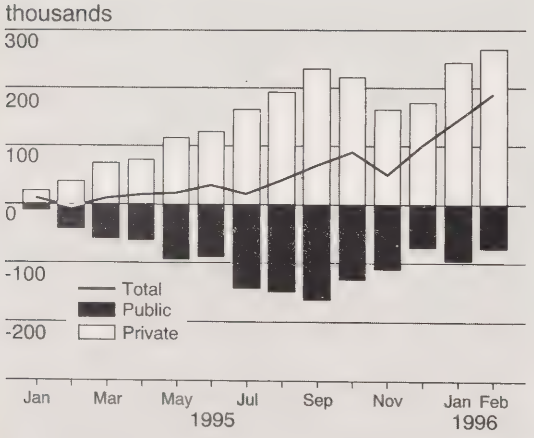
With production costs rising slightly faster than prices, corporate profits declined modestly in the fourth quarter. Nonetheless, profits increased nearly 15% for 1995 as a whole, raising their share of GDP to 8.4%, its highest level since 1989, but leaving it well below the 9.9% average from 1960 to 1994.

Employment growth picks up

In the last three months, 137,000 net new jobs have been created. This followed a 12-month period in which only 39,000 new jobs were created. The gain since November has been mostly in the private sector, where over 100,000 new jobs were created. This recent gain continues a longer-term trend where the private sector has been the engine of job growth, but with much of the gain offset by declines in public-sector employment.

Despite the stronger employment growth in the last three months, the unemployment rate has been relatively stable at 9.6%. This reflected a pick-up in labour-force participation in response to better job opportunities.

Chart 4
Cumulative employment change since December 1994



First quarter indicators

The first quarter outlook is generally positive. The recent job gains have left the average level of employment in January and February 0.6% (quarterly rate) above the fourth quarter level. In January, house resales jumped sharply and department store sales, despite a decline in the month, remained above their fourth quarter average. Further, average sales of motor vehicles in January and February were above their fourth-quarter average. On the other hand, despite an increase of 13% in February, average housing starts in January and February were about 7% below their fourth quarter average.

Interest rates decline

The monetary easing that began early last year halted in early March, at least temporarily, when the U.S. reported an unexpectedly large increase in employment. With that, interest rates in the U.S., especially long rates, jumped, resulting in similar increases in Canada. However, Canadian rates remained well below earlier peaks, as continuing economic weakness, low inflation, and fiscal restraint by all levels of government have put downward pressure on rates, especially short rates. Since March 1995, short rates are down over 300 basis points, with over half of that since the October referendum in Quebec. This narrowed the spread between short rates in Canada and the U.S. from about 250 in March 1995 to, at times, below 10 basis points. Spreads had not been this low in nearly a year and a half.

Long rates have fallen less than short rates, down about 190 basis points from their 1995 peaks. The recent increases, however, have left them high relative to inflation and still well above those in the U.S.

Since early October, the value of the Canadian dollar has weakened from above 75 cents U.S. to just above 73 cents U.S., partly a reflection of the narrowing spread in short-term interest rates between Canada and the U.S.

On March 8, the 3-month Treasury bill rate was 5.21% and the closing value of the Canadian dollar was 73.09 cents U.S.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 1996

KEY MESSAGES

- In the first quarter, final domestic demand rose at its strongest pace in over three years, with most major components strengthening. However, because of an unusually large decline in net exports, real GDP increased only modestly, continuing the slow growth which began in early 1995.
- Household spending rose sharply, reflecting employment gains in recent months and significant reductions in interest rates over the last year. Machinery and equipment investment continued to grow strongly and residential investment increased after six consecutive quarterly declines.
- Canadian short-term interest rates have dropped relative to those in the United States and are now below U.S. rates for the first time since 1983. The differential in long-term rates has also narrowed and is a full percentage point lower than in late last October.

SUMMARY[1]

Final domestic demand rose sharply in the first quarter, unlike in the previous four (Chart 1), with all major components strengthening except for non-residential construction and government spending on goods and services. A rise in inventory investment also contributed to rising GDP. However, overall growth was held back by an unusually large drop in exports, which had been the primary source of growth since the recession. This decline was in part due to temporary factors such as a drawdown of inventories in the United States and a strike in the United States that disrupted Canada's automotive exports. Growth was also modestly inhibited in the quarter by a strike in the Ontario civil service.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data in this document is 7 a.m. June 28, 1996.

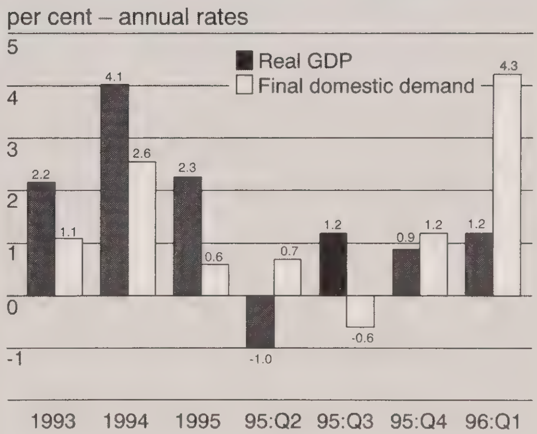
Domestic cost pressures remained subdued, as unit labour costs were more or less unchanged relative to the previous quarter. This, combined with slow GDP growth, resulted in little in the way of inflation pressure.

Low inflation, fiscal restraint at both the federal and provincial levels, reduced current account deficits and slow economic growth have permitted an easing in monetary conditions, with interest rates down sharply from levels early last year.

Household Spending Rises Firmly

Real consumer spending increased 3.7% in the first quarter, with gains in all broad categories: durables, semi-durables, non-durables and services. A particularly strong gain was recorded in the interest-sensitive automotive category. The increased consumer confidence (as measured by the Conference Board) that accompanies lower interest rates and rising employment contributed to these gains. As disposable income rose along with spending, the personal savings rate fell only slightly to 6.4% in the first quarter from 6.5% in the fourth. However, a large part of the increase in disposable income came from buy-out

Chart 1
Real GDP and final domestic demand



payments related to the termination of the Western Grain Transportation Act subsidy. About half of the total pay-out expected in 1996 was made in the first quarter.

Residential investment, another interest-sensitive sector, registered a sharp gain of 15.4%. This followed six consecutive quarterly declines. The strength in the quarter was in transfer costs (i.e., real estate commissions), as home resales rebounded strongly, and in new-home construction, as housing starts increased modestly for the second consecutive quarter.

Business Investment Rises

Business non-residential investment increased 12.0% in the quarter. This continued the pattern evident since early 1995, with very healthy growth in machinery and equipment investment and a significant decline in non-residential construction.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1994	1995	1995: Q3	1995: Q4	1996: Q1	Most recent	
Real gross domestic product	4.1	2.3	1.2	0.9	1.2	–	
GDP excluding inventories	3.6	2.0	2.2	2.6	0.0	–	
Final domestic demand	2.6	0.6	-0.6	1.2	4.3	–	
Government expenditure	-0.8	-0.3	-2.7	0.4	-0.9	–	
Consumer expenditure	2.9	1.4	2.5	0.0	3.7	–	
Residential investment	1.8	-15.1	-7.5	-7.2	15.4	–	
Business fixed investment	7.6	5.2	-7.6	10.4	12.0	–	
Non-residential construction	6.1	-5.6	-4.1	-10.4	-8.4	–	
Machinery and equipment	8.4	10.9	-9.2	20.7	21.3	–	
Business inventory change[1]	0.5	0.3	-1.0	-1.6	1.2	–	
Trade balance[1]	0.9	1.2	2.4	1.1	-3.9	–	
Exports	14.7	12.0	10.7	12.3	-6.1	–	
Imports	11.5	8.7	4.5	9.5	3.1	–	
Current account balance (nominal)	-22.2	-11.2	-9.2	-1.3	-7.8	–	
(percentage of GDP)	-3.0	-1.4	-1.2	-0.2	-1.0	–	
Real personal disposable income	0.7	1.1	-2.8	2.5	2.8	–	
Profits before taxes	34.4	13.1	-8.6	-15.3	-30.7	–	
Costs and prices (%, y/y)							
GDP price deflator	0.7	1.5	1.6	1.8	0.9	–	
Consumer price index	0.2	2.1	2.4	2.1	1.4	1.5	May 96
CPI – excluding food and energy	0.1	2.2	2.7	2.3	1.6	1.5	May 96
Unit labour costs	-1.3	0.8	1.3	2.1	1.8		
Wage settlements (total)	0.3	0.9	0.9	0.7	0.5	1.3	Apr 96
Labour market							
Unemployment rate	10.4	9.5	9.5	9.4	9.5	9.4	May 96
Employment growth (%, a.r.)	2.1	1.6	0.6	1.1	2.7	-1.0	May 96
Financial markets (average)							
Exchange rates (average)	73.24	72.88	73.77	73.75	73.04	73.36	27 June 96
Prime interest rate	6.88	8.65	8.08	7.75	7.00	6.50	27 June 96

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
Current account deficit as a share of GDP

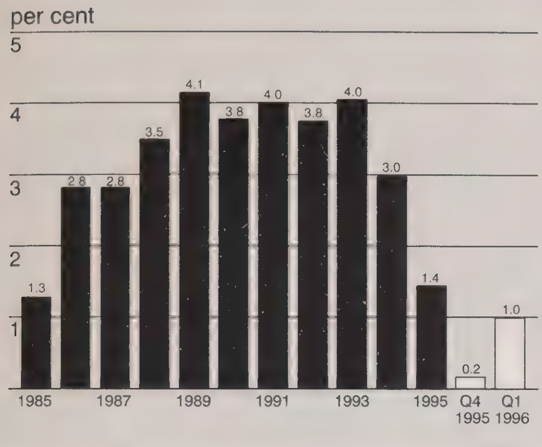
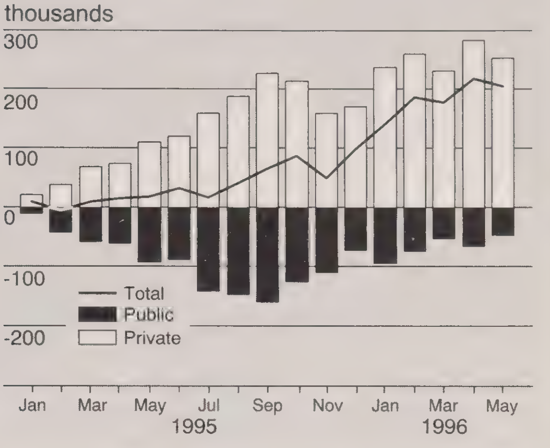


Chart 3
Cumulative employment change since December 1994



A Further Inventory Accumulation

Economic activity was also boosted in the quarter by increased inventory investment. The gain, which was largely in manufacturing and especially in paper products, raised the economy-wide inventory-to-sales ratio to its highest level since mid-1993. But the ratio remains well below the levels of the early 1990s.

Current Account Deficit Stays Low

External trade had been the engine of growth during most of the recovery, but it exerted a drag on real GDP growth in the first quarter. The real trade balance deteriorated $6.1 billion, as imports grew with domestic demand but exports fell significantly. Some of the drop in exports can be attributed to a reduction of inventories in the United States and a strike in the United States that disrupted Canada's automotive exports. Exports were also constrained by weak growth in a number of Canada's other major trading partners, notably those in Europe.

The deterioration in the trade balance increased the current account deficit from $1.3 billion in the fourth quarter to $7.8 billion in the first. However, relative to GDP, the current account deficit remained near its lowest level in over 10 years (Chart 2).

Prices, Costs and Profitability

Domestic cost performance remained good. After growing between 2% to 3% in the previous three quarters, unit labour costs were virtually unchanged in the first, leaving them 1.8% above their level from a year ago.

GDP inflation (the broadest measure of inflation for Canadian-produced goods and services) continued to be moderate. The implicit price index for GDP actually fell in the first quarter, partly reflecting a compositional swing away from demand components with faster rising prices.

With price increases limited by slow growth, corporate profits declined for the fourth consecutive quarter, taking them 15.0% below year-earlier levels. The declines in the quarter were concentrated in non-financial industries where over two-thirds of corporations saw reductions. The decrease was particularly notable in the wood and paper industries, where prices have been falling. As a result, profit's share of GDP declined to 7.1%, remaining well below its long-run average from 1960 to 1994 of 9.9%. It remained, however, well above its trough of 4.8% set at the end of 1991 thanks to strong growth in 1994 and early 1995.

Employment Growth Picks Up

The pace of job creation has picked up markedly in recent months. During the first 11 months of 1995, total employment rose by only 50,000. But in the following six months to the end of May 1996, 157,000 net new jobs were created. The private sector has been the engine of job growth for some time (Chart 3). Indeed, from the end of 1993 to the end of 1995, employment increased more in Canada than in all the European G-7 countries and Japan combined.

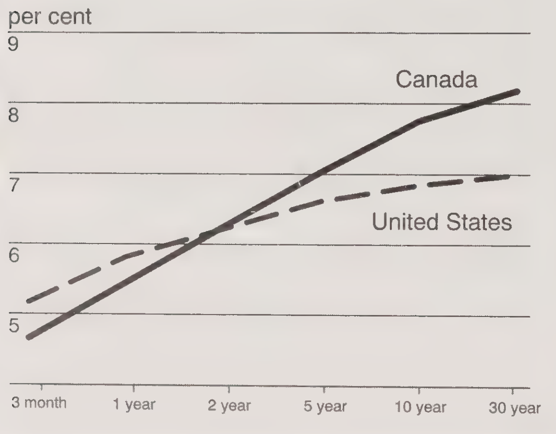
While employment growth has been strong on average in recent months, the labour force has grown at a similar pace. As a result, the unemployment rate has remained relatively unchanged. In May, it was 9.4%.

Second Quarter Indicators

The outlook for the second quarter is positive. First, despite a decline in May that partly offset a gain of 40,000 jobs in April, average employment for those two months was 0.3% (quarterly rate) above the first-quarter average. A second positive sign is that real GDP at factor costs rose 0.5% (monthly rate) in April and was 0.4% (quarterly rate) above its first quarter average. Much of that reflected a sharp rebound in motor vehicle production in April and the end of the civil service strike in Ontario. But motor vehicle production rose again in May, leaving the April/May average nearly 7% (quarterly rate) above that in the first-quarter. Also, in May, housing starts jumped to their highest level since January 1995.

Not all signs, however, are positive. Despite a sharp jump in May, average motor vehicle sales in April and May were below their first-quarter average. Also, surveys of manufacturers reveal growing concern about inventory levels.

Chart 4
Canada and U.S. Government Bill/Bond Yield Curves (as of June 27)



Interest Rates Decline

The monetary easing that began early last year has continued. Low inflation, fiscal restraint at both the federal and provincial levels, more modest current account deficits and slow growth have put downward pressure on interest rates, especially short-term rates. Since their peak in March 1995, short rates are down over 350 basis points. Canadian rates have fallen more than U.S. rates and now are below those in the United States for the first time since 1983. A negative spread of about 50 basis points has developed between Canadian and U.S. yields on 3-month treasury bills (Chart 4). Negative spreads have also emerged on bonds with maturities up to two years.

Long rates have fallen some 200 basis points since early 1995, which is about 100 basis points more than the decline in U.S. rates. U.S rates have moved back up more than Canadian rates since early March and as a result, the spread with U.S. long rates recently narrowed to less than 100 basis points, a full percentage point less than in late last October. However, Canadian long-rates remain high relative to Canada's low inflation.

The Canadian dollar has traded in a fairly narrow range of 72 to 74 cents U.S. since January despite the emergence of negative interest-rate spreads at the short end.

On June 27, the 3-month treasury bill rate was 4.68% and the closing value of the Canadian dollar was 73.36 cents U.S.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre (613) 995-2855. For other inquiries about this publication, contact Jeremy Rudin (613) 992-2370.
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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE

SEPTEMBER 1996

KEY MESSAGES

- In the second quarter, real GDP rose by 1.3% for the second consecutive quarter.
- Growth returned to being export-led. As a result, the real trade balance rose to its highest level since 1985, yielding the first quarterly current account surplus since 1984.
- The recovery in production would have been stronger but for business working down the excess inventories that had accumulated during 1995. Lower inventories now will help set the stage for growth in the second half of the year to be more in line with underlying demand growth.
- Employment surged in August, bringing total net job creation in July and August to over 100,000.
- Short-term interest rates have fallen about 60 basis points since the end of June alone, bringing the cumulative decline since January 1995 to over 425 basis points. Canadian rates have continued to drop relative to those in the United States, with the negative spread between Canadian and U.S. yields on 3-month Treasury bills at about 125 basis points. Indeed, Canadian rates are now below comparable U.S. rates up to 5-year maturities.

SUMMARY[1]

The demand for Canadian goods has been gathering strength since the second half of last year (Chart 1) and, fuelled by strong growth in exports, continued to do so in the second quarter. Since imports declined with domestic demand, the trade balance rose sharply, producing Canada's first current account surplus since 1984.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data in this document is September 6, 1996.

However, as has been the case since the second half of 1995, this stronger demand has yet to translate into strong production growth, as business has slowed inventory investment. In the second quarter, inventories actually shrank substantially.

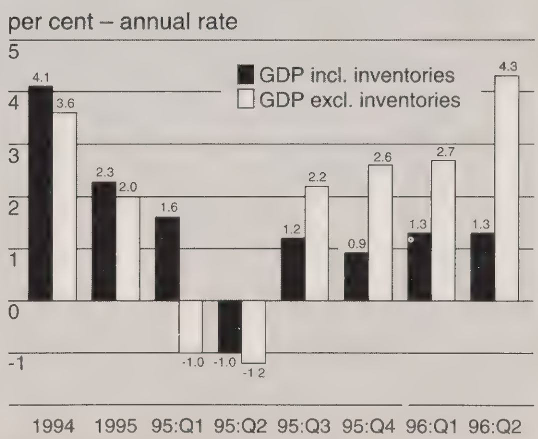
Further, final domestic demand – spending by households, business and government on goods and services and capital formation – was largely unchanged in the quarter, with a sharp jump in residential investment largely offset by falling business investment in plant and equipment.

Domestic inflation and cost pressures remained subdued, with unit labour costs rising moderately in the second quarter. Low inflation, fiscal restraint at federal, provincial and local levels and an improved current account balance have permitted interest rates to fall sharply from levels early last year.

External trade boosts growth

External trade was the engine of growth in the second quarter, as it has been for most of the recovery. Real exports increased due to stronger growth in the United States and the ongoing recoveries in Japan and the European G-7 countries and Canada's excellent

Chart 1
Growth in GDP including and excluding inventory investment



competitiveness. Also, part of the increase can be attributed to a rebound from the impact in the first quarter of strike activity in the United States on Canada's automotive production.

At the same time, real imports weakened due to a sharp inventory liquidation and little change in final domestic demand. As a result, the real trade balance improved by $7.9 billion to its highest level since 1985.

Sharp inventory decumulation

Economic activity was slowed significantly in the second quarter by a substantial inventory disinvestment. This reaction by producers to an inventory build-up during 1995 returned the economy-wide inventory-to-sales ratio to a level more in line with its downward trend.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1994	1995	1995: Q4	1996: Q1	1996: Q2	Most recent	
Real gross domestic product	4.1	2.3	0.9	1.3	1.3	–	
GDP excluding inventories	3.6	2.0	2.6	2.7	4.3	–	
Final domestic demand	2.6	0.6	1.2	5.2	-0.3	–	
Government expenditure	-0.8	-0.3	0.4	-0.9	-0.1	–	
Consumer expenditure	2.9	1.4	0.0	5.1	0.2	–	
Residential investment	1.8	-15.1	-7.2	22.4	27.4	–	
Business fixed investment	7.6	5.2	10.4	10.2	-10.3	–	
Non-residential construction	6.1	-5.6	-10.4	-2.3	-3.4	–	
Machinery and equipment	8.4	10.9	20.7	15.7	-13.0	–	
Business inventory change[1]	0.5	0.3	-1.6	-1.4	-2.9	–	
Trade balance[1]	0.9	1.2	1.1	-2.4	5.2	–	
Exports	14.7	12.0	12.3	-1.6	6.5	–	
Imports	11.5	8.7	9.5	4.1	-5.6	–	
Current account balance (nominal)	-22.2	-11.2	-1.3	-6.5	4.6	–	
(percentage of GDP)	-3.0	-1.4	-0.2	-0.8	0.6	–	
Real personal disposable income	0.7	1.1	2.5	2.1	-1.9	–	
Profits before taxes	34.4	13.1	-15.3	-21.4	-5.5	–	
Costs and prices (%, y/y)							
GDP price deflator	0.7	1.5	1.8	1.0	0.9	–	
Consumer price index	0.2	2.1	2.1	1.4	1.4	1.2	July 96
CPI – excluding food and energy	0.1	2.2	2.3	1.6	1.4	1.4	July 96
Unit labour costs	-1.3	0.8	2.1	1.8	1.3	–	
Wage settlements (total)	0.3	0.9	0.7	0.5	0.7	0.5	June 96
Labour market							
Unemployment rate	10.4	9.5	9.4	9.5	9.6	9.8	July 96
Employment growth (%, a.r.)	2.1	1.6	1.1	2.7	0.7	1.7	July 96
Financial markets (average)							
Exchange rates (average)	73.24	72.88	73.75	73.04	73.29	72.85	Sept. 6, 96
Prime interest rate	6.88	8.65	7.75	7.00	6.50	5.75	Sept. 6, 96

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
Personal savings rate

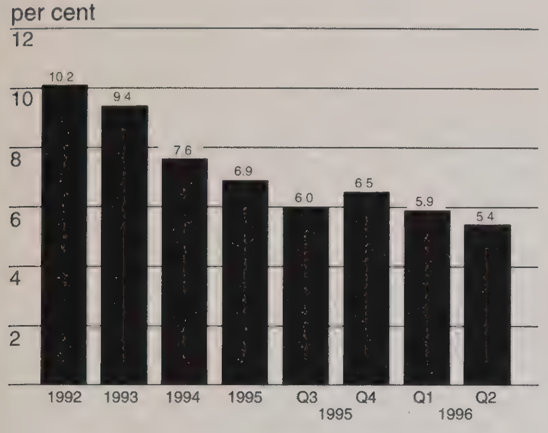
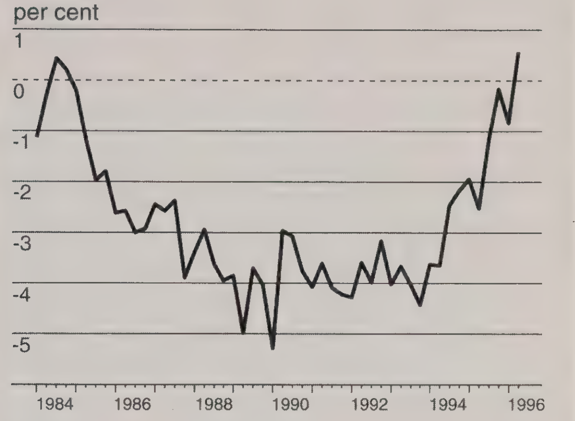


Chart 3
The current account balance as a share of GDP



Household spending largely unchanged

Real consumer spending increased modestly in the quarter after rising sharply in the first quarter. This weakness was due to falling real disposable income, a reflection of slow labour income growth, lower investment income, lower federal payments related to the *Western Grain Transportation Act* subsidy buy-outs, and higher tax payments.

With personal disposable income rising more modestly than spending, the personal savings rate fell from 5.9% in the first quarter to 5.4% in the second, its lowest level since 1970 (Chart 2).

Residential investment has responded to the downward trend in interest rates, rising 27.4% in the quarter, the second consecutive gain.

Business investment falls

Business non-residential investment fell 10.3% in the quarter. Machinery and equipment investment, which had been one of the few sources of domestic demand strength, registered an uncharacteristic sharp drop while non-residential construction continued to weaken, as it has for some time.

Current account surplus

The current account went from a deficit of $6.5 billion in the first quarter to a surplus of $4.6 billion in the second, the first surplus since 1984 (Chart 3). The sharp rise in the nominal merchandise trade surplus played a major role. Further, a record level of spending by non-residents in Canada helped to sharply reduce the travel deficit. Finally, the deficit in investment income flows fell about $2 billion, reflecting lower corporate profits and the downward trend in interest rates.

Prices, costs and profitability

Domestic cost performance remained good. Unit labour costs rose a modest 1.3% in the quarter after having fallen marginally in the first, leaving them 1.3% above their level from a year earlier.

GDP inflation (the broadest measure of inflation for Canadian-produced goods and services) continued to be moderate. The implicit price index for GDP rose 1.9% at an annual rate in the second quarter, but was only 0.9% above its level of a year earlier.

With slow growth limiting price increases, corporate profits fell yet again, dropping 13.5% below their level in early 1995. Declines were concentrated in the non-financial sector, where nearly half of the industries saw reductions. Decreases were particularly notable in the wood and paper industries, especially in pulp and paper. The profit share of GDP fell to 7.2%, still well above its trough of 4.8% set at the end of 1991 but still well below its long-run average from 1960 to 1994 of 9.9%.

Employment surges

The pace of job creation has rebounded sharply after job losses in May and June, when producers were reducing inventories. Employment rose by 82,000 in August, bringing the July/August total gain to just over 100,000. This followed a net loss of 68,000 jobs in May and June. 202,000 net new jobs have been created in the nine months since November, with the private sector accounting for the entire gain and more. Indeed, from the end of 1993 to the first quarter of 1996, the growth rate of employment has kept pace with that of the United States and exceeded those of each of the European G-7 countries and Japan.

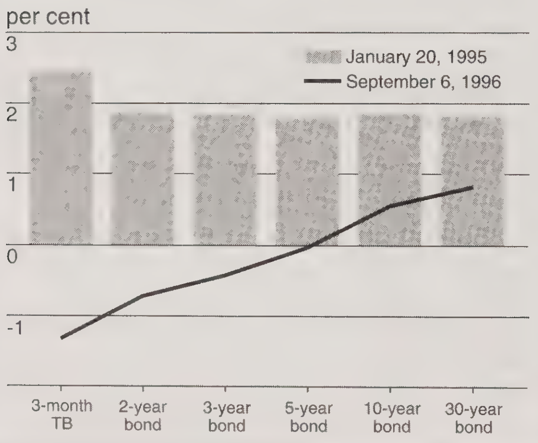
While employment growth has been strong, the labour force has continued to grow along with the population. As a result, the unemployment rate, at 9.4% in August, is the same as it was in November 1995.

Third quarter indicators

The outlook to date for real GDP growth in the third quarter is positive. Recent surveys suggest the inventory correction may be close to complete, which should allow production to grow at a pace more in line with underlying demand growth. The employment surge in August is consistent with stronger production growth. Other indicators are also encouraging.

Home resales and motor vehicle production both rose sharply in July to levels well above their second-quarter averages. Housing starts in that month also exceeded their second-quarter averages. Finally, increased motor vehicle sales in August left average monthly sales to date in the third quarter above that in the second.

Chart 4
Canada-U.S. interest rate spreads



Interest rates decline further

Since early 1995, fiscal restraint, an improving current account, slow growth and low inflation have allowed interest rates to decline, an easing which has continued through recent months. Short-term interest rates have fallen about 60 basis points since the end of June alone, bringing the cumulative decline since January 1995 to over 425 basis points. This drop has brought the negative spread between Canadian and U.S. yields on 3-month Treasury bills to about 125 basis points (Chart 4). Negative spreads have emerged on bonds with maturities up to five years.

While long rates have backed up since early 1996, they have done so more in the United States than in Canada. As a result, long rates are now down almost 220 basis points since early 1995. The spread with U.S. 10-year bonds has narrowed to less than 60 basis points, over a full percentage point less than a year earlier.

The Canadian dollar has traded in a fairly narrow range of 72 to 74 cents U.S. since January despite the emergence of negative interest-rate spreads up to 5-year maturities.

On September 6, the 3-month Treasury bill rate was 4.00% and the closing value of the Canadian dollar was 72.85 cents U.S.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE

DECEMBER 1996

KEY MESSAGES

- In the third quarter, real GDP grew 3.3%, the fastest pace since the fourth quarter of 1994.
- This reflected stronger demand by Canadian business plus continued strong foreign demand. Notably, a sharp rebound in machinery and equipment investment and a second consecutive robust gain in residential investment resulted in solid growth in final domestic demand. Unlike the second quarter, this growing demand was met out of increased production rather than a reduction in inventories.
- Part of the increased demand was satisfied by imports, pushing import growth well above that of exports and reducing the real trade surplus. However, higher export prices helped support the second quarterly current account surplus in a row, the first surpluses since 1984.
- Domestic cost pressures continued to be moderate, with a decline in unit labour costs in the third quarter relative to the second leaving them only 0.7% above their level of a year earlier.
- Indicators for fourth quarter growth are generally positive to date.
- Interest rates have fallen over a percentage point since early September, bringing the cumulative decline since January 1995 to over 5 percentage points for short rates and 3 percentage points for long rates. Also, Canadian rates have dropped relative to those in the United States, with the negative spread between Canadian and U.S. yields on 3-month Treasury bills at about 2 percentage points. Indeed, Canadian rates have been below comparable U.S. rates up to, at times, 10-year maturities for the first time since 1985.

SUMMARY[1]

The demand for Canadian goods has been gathering strength since the second half of last year. In the third quarter, this finally translated into stronger production growth, as business stopped running down inventories (Chart 1).

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data in this document is noon, December 9, 1996.

Final domestic demand – spending by households, business and government on goods and services and capital formation – rose sharply in the quarter, as machinery and equipment investment soared and residential investment registered another strong gain. However, consumer spending growth continued to be sluggish while government spending fell sharply.

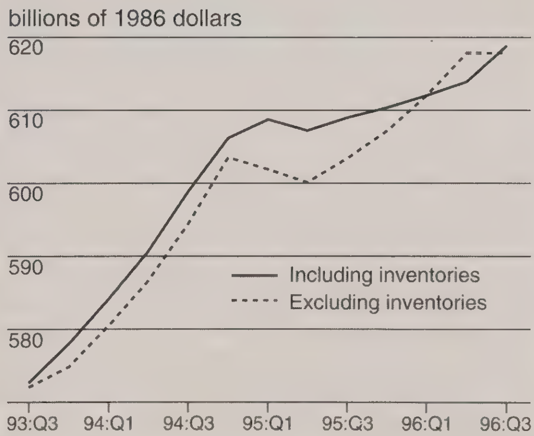
Domestic inflation and cost pressures remained subdued, with unit labour costs falling in the third quarter. Low inflation, fiscal restraint at federal and provincial levels and another current account surplus allowed interest rates to continue their sharp declines.

Inventory investment stops falling

An important factor in strengthening domestic demand was the largest positive swing in inventory investment since 1991. This swing was not a surprise given the sharp run-down in inventories in the second quarter. However, it was increased farm inventories due to a strong grain harvest that modestly boosted the overall stock. The stock of business non-farm inventories fell slightly, albeit by nowhere near as much as in the second quarter.

With sales growth exceeding that of inventories, the economy-wide inventory-to-sales ratio fell for a fourth consecutive quarter to near its lowest point ever and in

Chart 1
GDP including and excluding inventory investment



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line with its long-standing downward trend. This should allow production to grow with underlying demand in the future.

Business investment soars

Final domestic demand growth registered a sharp pick-up to 3.8% (Chart 2), led by business non-residential investment, which jumped 23.5% in the quarter. Machinery and equipment investment, which has generally been a source of strength in recent quarters, soared nearly 33% after a temporary dip in the second quarter. Non-residential construction rose by about 3%, following a marginal decline in the second quarter, as oil and gas drilling resumed after being delayed by adverse weather in the second quarter.

Residential investment also continued to respond to lower interest rates, rising nearly 17% in the quarter, building on the 26% surge in the second quarter.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1994	1995	1996: Q1	1996: Q2	1996: Q3	Most recent	
Real gross domestic product	4.1	2.3	1.1	1.2	3.3	–	
GDP excluding inventories	3.6	2.0	3.2	3.9	0.0	–	
Final domestic demand	2.6	0.6	4.7	0.2	3.8	–	
Government expenditure	-0.8	-0.3	-1.9	-1.6	-3.6	–	
Consumer expenditure	2.9	1.4	5.1	0.7	1.3	–	
Residential investment	1.8	-15.1	22.7	26.3	16.9	–	
Business fixed investment	7.6	5.2	8.5	-6.6	23.5	–	
Non-residential construction	6.1	-5.6	4.9	-0.2	3.1	–	
Machinery and equipment	8.4	10.9	10.0	-9.2	32.8	–	
Business inventory change[1]	0.5	0.3	-2.0	-2.6	3.3	–	
Trade balance[1]	0.9	1.2	-1.8	4.7	-3.5	–	
Exports	14.7	12.0	-1.7	9.7	8.5	–	
Imports	11.5	8.7	2.5	-1.5	18.2	–	
Current account balance (nominal)	-22.2	-11.2	-6.7	4.4	2.2	–	
(percentage of GDP)	-3.0	-1.4	-0.9	0.6	0.3	–	
Real personal disposable income	0.7	1.1	0.6	-1.4	0.8	–	
Profits before taxes	34.4	13.1	-10.6	-0.6	51.9	–	
Costs and prices (%, y/y)							
GDP price deflator	0.7	1.5	1.2	1.1	1.3	–	
Consumer price index	0.2	2.1	1.4	1.4	1.4	1.8	Oct. 96
CPI – excluding food and energy	0.1	2.2	1.6	1.4	1.3	1.3	Oct. 96
Unit labour costs	-1.3	0.8	1.8	1.5	0.7	–	
Wage settlements (total)	0.3	0.8	0.5	0.7	1.2	1.6	Sept. 96
Labour market							
Unemployment rate	10.4	9.5	9.5	9.6	9.7	10.0	Oct. 96
Employment growth (%, a.r.)	2.1	1.6	2.7	0.7	0.5	3.7	Oct. 96
Financial markets (average)							
Exchange rates (average)	73.24	72.88	73.04	73.29	72.99	73.78	Dec. 9, 96
Prime interest rate	6.88	8.65	7.00	6.50	5.92	4.75	Dec. 9, 96

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
Growth in final domestic demand and real GDP

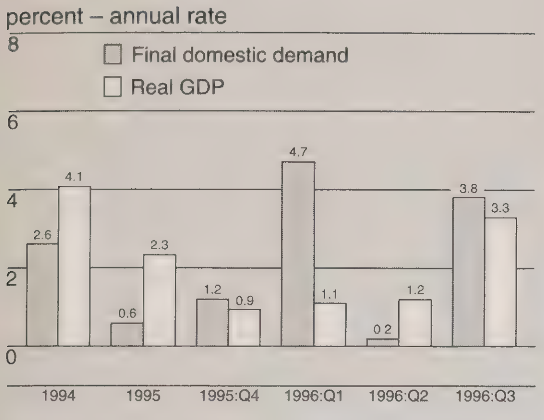
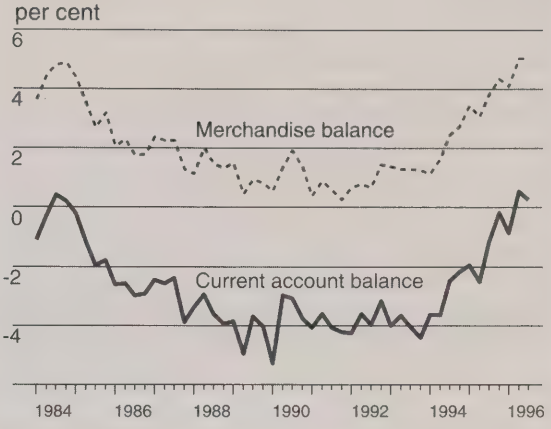


Chart 3
The current account balance as a share of GDP



Household spending growth still sluggish

Real consumer spending increased modestly again in the quarter. Gains were more or less limited to services and non-automotive durables. This sluggishness was largely due to even more modest growth in real personal disposable income. Slow labour income growth due to slow employment and real wage gains in the quarter continued to weigh on household spending.

With spending rising faster than disposable income, the personal savings rate has fallen from 5.6% in the first quarter to 5.2% in the second and 5.1% in the third, its lowest level since 1970. However, one reason that the savings rate is low is that inflation is low. During inflationary periods, the higher investment income (from higher nominal interest rates) tends to be saved to preserve the real value of capital. Thus, the highest personal savings rates were seen during the years of double-digit inflation.

Exports remain strong but imports surge

Export growth eased to a still robust 8.5% in the third quarter, driven by continued but slowing growth in the United States, ongoing recoveries in Canada's overseas major export markets, and Canada's excellent competitive position.

The volume of imports was up sharply (18.2%) in the third quarter. A major factor was a sharp rise in imports of machinery and equipment that accompanied increased domestic investment. Another likely factor was that the inventory decline in the second quarter depressed imports at that time. Overall, the real trade surplus (goods and services combined) declined by $5.5 billion, with the reduction concentrated in the merchandise trade balance.

Current account remains in surplus

The current account surplus was halved from $4.4 billion in the second quarter to $2.2 billion in the third (i.e. from 0.6% of nominal GDP to 0.3% of GDP (Chart 3)). But the decline in the real merchandise trade surplus was not the main factor in this development.

The nominal merchandise surplus actually rose modestly to another record high in the third quarter, as the prices of Canada's merchandise exports rose faster than the prices of Canada's merchandise imports.

The lower current account surplus was due, in part, to an increase in the services deficit of about $1 billion, largely reflecting a deterioration in the travel account, as receipts fell while Canadian spending outside of Canada rose. Also, with the balances for interest, dividends and retained earnings all worsening, the deficit in investment income increased by over $1 billion.

Prices, costs and profitability

Underlying domestic cost pressures continued to be moderate. Unit labour costs fell about 1% in the third quarter after having risen in the second, leaving them only 0.7% above their level from a year earlier.

GDP inflation (the broadest inflation measure for Canadian-made products) reached its fastest rate – 2.8% – since the third quarter of 1992. But this largely reflected the surge in export prices. The implicit price index for GDP was only 1.3% above its level of a year earlier.

With these price *increases* and cost d*ecreases*, corporate profits surged by over 50%. Gains were concentrated in the non-financial sector, notably in the wood and paper industries. The profit share of GDP rose to 8.2%, well above its trough of 4.8% at the end of 1991 but still well below its longer-run average of about 10%.

Employment gains

The pace of job creation has improved since the middle of the year. After job losses in May and June, when producers were sharply reducing inventories, and despite losses in September, the cumulative gain from June to November was over 100,000 net new jobs.

While employment growth generally has been strong, the labour force has grown faster than the population, as the participation rate has picked up somewhat in recent months. As a result, the unemployment rate, at 10.0% in November, is the same as it was in June.

Recent indicators

The outlook to date for growth in the fourth quarter is positive. Interest rates have declined further since the end of the third quarter. Business confidence remains well above its average level over the last two decades according to the Conference Board. The solid employment gain in October, coupled with the very modest gain in November, is consistent with further production growth. Other indicators are also encouraging. Home resales and motor vehicle sales both appear to be growing strongly and housing starts in November rose to their highest level in two years, more than offsetting a drop in October.

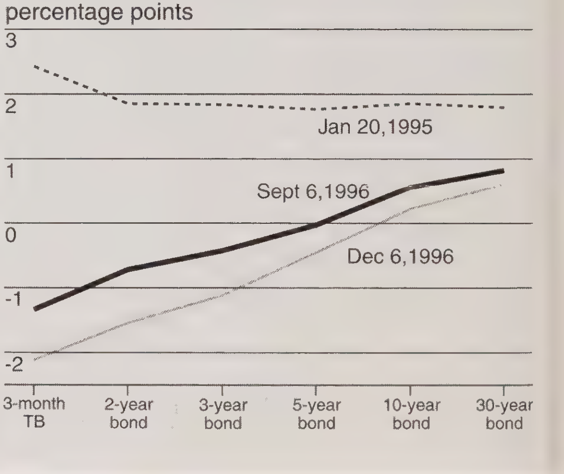
Interest rates decline further

Since early 1995, fiscal restraint by the federal and provincial governments, the improved current account, slow growth and low inflation have allowed interest rates to decline. Short-term interest rates have fallen more than a percentage point since early September, bringing their cumulative decline since January 1995 to over 5 percentage points. This has brought about a rather large negative spread between Canadian and U.S. yields on 3-month Treasury bills (Chart 4).

Long rates also have fallen about a percentage point since early September and are now down over 3 percentage points since early 1995. Indeed, negative spreads with U.S. rates have emerged, at times, on bonds with maturities up to 10 years for the first time since 1985.

Despite the emergence of large negative interest-rate spreads, the Canadian dollar strengthened to over 75 cents U.S. in early November. Since then, however, the dollar has returned to its trading range for most of 1996 – 72 to 74 cents U.S.

Chart 4
Canada-U.S. interest rate spreads



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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE — MARCH 1997

KEY MESSAGES

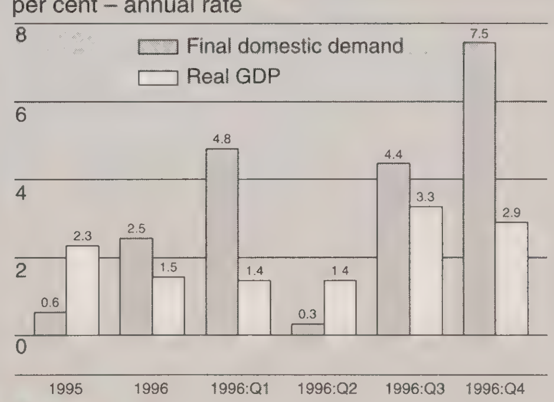
- Real GDP grew 2.9% in the fourth quarter of 1996, a pace slightly below that in the third but much healthier than in 1995 and the first half of 1996. Growth was 1.5% for 1996 as a whole.
- Stronger Canadian demand was the source of strength in the fourth quarter. Final domestic demand grew at its strongest pace since the third quarter of 1987, as previous declines in interest rates fuelled significant gains in interest-sensitive expenditures. In particular, consumer spending picked up, especially on durables, while residential and non-residential investment posted strong gains. A large increase in inventory investment also added to demand for the second consecutive quarter.
- Overall, growth was held back by external trade. Imports rose with Canadian demand, especially in import-sensitive categories such as machinery and equipment. Exports fell sharply due to a weakening in foreign demand in the quarter and the disruption in Canadian motor vehicle supply by the GM strike in October. With imports rising and exports falling, the real trade balance fell $12 billion to its lowest level since the first quarter of 1994. This pushed the current account back into a small deficit.
- Domestic cost and price pressures remained subdued.
- With employment growth continuing to lag output growth, the unemployment rate remains relatively unchanged.
- Interest rates remain well below their levels of early 1995. The cumulative drop is over 5 percentage points for short rates and 3 percentage points for long rates. The negative spreads that developed between Canadian and comparable U.S. rates of up to 10-year maturities appear to be more entrenched. The spread on 3-month Treasury bills continues to be more than 2 percentage points.

SUMMARY[1]

Demand by Canadian consumers and business has gathered steam (Chart 1). Final domestic demand – spending by households, business and government on goods and services and capital formation – rose a sharp 7.5% in the fourth quarter, energized by previous declines in interest rates. Personal spending picked up, particularly on housing and interest-sensitive durables such as motor vehicles. Business non-residential investment rose significantly while a second consecutive large jump in investment in business inventories added to Canadian demand. However, external trade held back overall growth.

Domestic inflation and cost pressures remained subdued, with unit labour costs in the fourth quarter only modestly above the level of a year earlier.

Chart 1
Growth in final domestic demand and real GDP



[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data in this document is March 7, 1997.

Department of Finance Canada — Ministère des Finances Canada

Canada

Low inflation and fiscal restraint at federal and provincial levels have allowed the sharp drop in interest rates since early 1995 to be maintained.

Household spending picks up

Real consumer expenditure in the quarter responded strongly to lower interest rates, greater wealth and a firming in consumer confidence. Spending growth was strongest in the interest-sensitive durables category. Spending on new motor vehicles increased at its fastest pace in more than five years.

This pick-up occurred despite continued sluggishness in real personal disposable income growth. The strongest growth in labour income (6.6%) since the second quarter of 1989 was partly offset by a decline in measured personal investment income (due partly to lower interest rates), a fall in farm income (due to declines in agricultural prices), lower EI payments and

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1995	1996	1996: Q2	1996: Q3	1996: Q4	Most recent	
Real gross domestic product	2.3	1.5	1.4	3.3	2.9	–	
GDP excluding inventories	2.0	2.3	3.9	0.6	0.3	–	
Final domestic demand	0.6	2.5	0.3	4.4	7.5	–	
Government expenditure	-0.3	-1.9	-1.8	-4.2	-0.7	–	
Consumer expenditure	1.4	2.4	0.6	2.0	5.6	–	
Residential investment	-15.1	11.5	35.2	19.6	22.9	–	
Business fixed investment	5.2	6.6	-7.3	25.1	23.4	–	
Non-residential construction	-5.6	-3.2	-0.1	0.0	5.8	–	
Machinery and equipment	10.9	11.0	-10.1	36.8	30.7	–	
Business inventory change[1]	0.3	-0.8	-2.4	2.7	2.6	–	
Trade balance[1]	1.2	-0.2	4.5	-3.7	-7.5	–	
Exports	12.0	4.5	8.4	8.6	-10.1	–	
Imports	8.7	5.1	-2.2	18.8	7.4	–	
Current account balance (nominal)	-11.2	-1.7	4.3	1.2	-6.8	–	
(percentage of GDP)	-1.4	-0.2	0.5	0.1	-0.8	–	
Real personal disposable income	1.1	-0.2	-1.8	-1.4	0.8	–	
Profits before taxes	13.1	0.2	2.0	50.6	19.3	–	
Costs and prices (%, y/y)							
GDP price deflator	1.5	1.3	1.0	1.1	1.6	–	
Consumer price index	2.1	1.6	1.4	1.4	2.0	2.2	Jan 97
CPI – excluding food and energy	2.2	1.5	1.4	1.3	1.5	1.8	Jan 97
Unit labour costs	0.8	1.3	1.5	0.8	1.1		
Wage settlements (total)	0.8	0.9	0.7	1.2	1.5	0.7	Dec 96
Labour market							
Unemployment rate	9.5	9.7	9.6	9.8	9.9	9.7	Feb 97
Employment growth (%, a.r.)	1.6	1.3	0.6	0.6	1.4	-1.6	Feb 97
Financial markets (average)							
Exchange rates (average)	72.88	73.34	73.29	72.99	74.06	73.28	Mar 6, 97
Prime interest rate	8.65	6.06	6.50	5.92	4.83	4.75	Mar 6, 97

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
Personal savings rate

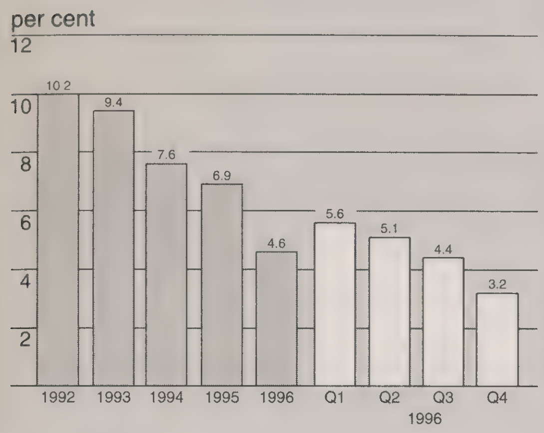
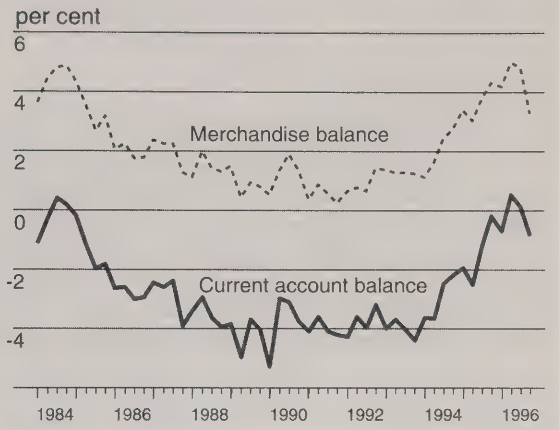


Chart 3
The current account balance as a share of GDP



increased taxes. With spending rising faster than disposable income, the personal savings rate fell to 3.2%, its lowest level since 1961 (Chart 2). The personal savings rate for 1996 as a whole was 4.6%.

This lower savings rate has resulted from the positive impacts on spending of lower interest rates, increased wealth – including that from capital gains on equity and bond holdings that are not captured in the income and expenditure accounts – and firming consumer confidence.

Investment growth remains strong

Business non-residential investment jumped more than 20% for the second consecutive quarter. Machinery and equipment investment, which has generally been a source of strength in recent quarters, soared more than 30% after having risen nearly 37% in the third quarter. Non-residential construction rose by about 6%, led by gains in engineering works rather than commercial buildings.

Residential investment continued to respond to lower interest rates, rising nearly 23%, the fourth consecutive large quarterly gain. The gain in the fourth quarter came mostly from a strong gain in home resales, as investment in new construction fell somewhat.

Inventory investment adds to growth

Another source of strength in domestic demand was a second consecutive large increase in investment in inventories. This followed a previous run-down in inventories. However, given the strong increase in demand, the economy-wide inventory-to-sales ratio is still near its lowest point ever.

Imports grow while exports weaken

The volume of imports continued to grow strongly, as domestic demand for import-intensive items like machinery and equipment was strong.

Real exports fell sharply, noticeably moderating overall economic growth in the quarter. Motor vehicle sales weakened in the United States and that, along with the GM strike, lowered Canadian exports of automotive products. Overseas demand for Canadian products also moderated in the quarter, notably in Japan.

With imports rising and exports falling, the real trade balance on goods worsened by $14 billion to its lowest level since the second quarter of 1989.

Current account returns to small deficit

The current account moved to a small deficit in the fourth quarter from a small surplus in the third because of the deterioration in the goods trade balance (Chart 3). The deficits in services and investment income (including retained earnings) narrowed in the fourth quarter. Within services, the deficits in commercial services and travel both improved noticeably, with spending by non-residents on travel in Canada reaching a record level. The deficit in investment income improved by $1.7 billion due in large part to a sharp rebound in interest received by Canadians from non-residents following unusually low receipts in the previous quarter.

For 1996 as a whole, the current account deficit was the smallest since 1984, both in dollar terms and as a percentage of GDP.

Prices, costs and profitability

Underlying domestic cost pressures continued to be modest. Unit labour costs in the fourth quarter were only 1.1% above their level of a year earlier.

GDP inflation (the broadest inflation measure for Canadian products) was 2.5% in the fourth quarter using the implicit price deflator, but prices were only 1.6% above their level of a year earlier. However, the increase in the chain measure of GDP inflation (Statistics Canada's preferred measure) fell to 1.2% in the fourth quarter from 1.5% in the third.

Corporate profits surged nearly another 20% after having soared over 50% in the third quarter. Gains were concentrated in the financial sector, notably at chartered banks and insurance companies. Despite these gains, the share of corporate profits in GDP (8.6%) is only about equal to its level in early 1995.

Employment lags output growth

Output has grown faster than employment in recent quarters. Real output in the fourth quarter was 2.3% higher than in the same quarter of 1995 while employment was up only 1.3%. With average employment in the first two months of the year only slightly above the average in the fourth quarter following the loss of 19,000 jobs in February, slow employment growth has apparently continued into the first quarter.

Overall, a total of 116,000 net new jobs have been created since June 1996. With the relatively steady rate of participation in the labour market, these employment gains have brought the unemployment rate down to 9.7% in February from 10% in June.

First quarter indicators

The outlook for the first quarter is for continued growth. Business confidence remains well above its average over the last two decades according to the Conference Board of Canada. And Statistics Canada's survey of private and public investment intentions suggests non-residential investment in 1997 will increase at its fastest rate since 1994, with non-residential construction expected to reverse its declines in 1995 and 1996. Housing starts, home resales and motor vehicle production all appear to be growing strongly in the quarter.

Interest rates remain low

Fiscal restraint, the general improvement in the current account, low inflation and output below potential have allowed interest rates to decline since early 1995. Short-term interest rates have fallen over 5 percentage points while long rates have come down over 3 percentage points.

The negative spreads between Canadian and U.S. yields on bonds with maturities up to 10 years appear to have become more firmly entrenched. On 3-month Treasury bills, the negative spread remains greater than 2 percentage points.

The Canadian dollar has returned to a trading range of 72 to 74 cents U.S., a range it has been in for most of the last year, despite the emergence of these large negative interest rate spreads.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 1997

KEY MESSAGES

- Real GDP rose 3.4% in the first quarter of 1997, continuing the healthy pace set in the second half of 1996.
- Final domestic demand again grew strongly, as previous declines in interest rates continued to fuel economic activity. Interest-sensitive spending on plant and equipment, housing investment and consumer durables was especially robust.
- Real exports rebounded strongly from a drop in the previous quarter, reflecting both strong demand growth in the United States and a production rebound at Canadian GM plants after the strike in October.
- Economic growth was healthy in spite of a considerable slowdown in inventory investment as well as continued government restraint.
- From March through May, employment registered its strongest three-month gain since early 1989.
- Interest rates remain well below their levels of early 1995. The cumulative drop is over 5 percentage points for short rates and 3 percentage points for long rates. The negative spreads that developed between Canadian and comparable U.S. rates of up to 10-year maturities are now more entrenched. The spread on 3-month Treasury bills remains near 2 percentage points.

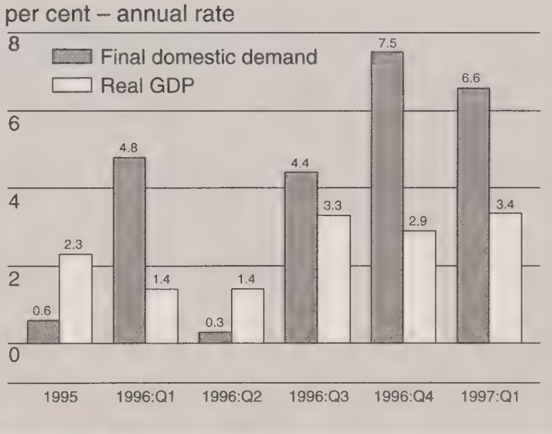
SUMMARY[1]

Final domestic demand – spending by households, business and government on goods and services and capital formation – rose 6.6% in the first quarter of 1997 (Chart 1), sparked by lower interest rates. Final domestic demand has risen at a 4.7% annual rate since the end of 1995. Interest-sensitive spending on housing, furniture and appliances and motor vehicles all strengthened in the quarter. Business non-residential investment surged over 20% for the third consecutive quarter.

Foreign demand also increased noticeably, as exports rebounded from a drop in the previous quarter. However, sharply weaker inventory investment by business restrained overall growth (Chart 1).

Domestic inflation and cost pressures remained subdued, with unit labour costs in the first quarter only modestly above their year-ago level.

Chart 1
Growth in final domestic demand and real GDP



[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut off date for data in this document is noon, June 6, 1997.

Solid household spending growth

Real consumer expenditure in the quarter again responded to lower interest rates, increasing wealth and firming consumer confidence. Growth was strongest in the interest-sensitive categories. Spending on new motor vehicles rose sharply while spending on furniture and appliances surged 12.4%, aided by increased housing activity.

The pickup in spending occurred despite the lack of growth in nominal personal disposable income. Higher earned income was offset by declines in measured personal investment income (due partly to lower interest rates), transfers from government (due partly to the end in the previous quarter of the federal payments tied to the elimination of the *Western Grain Transportation Act* subsidy) and by increased tax revenues. The personal savings rate fell to 1.7%, its

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1995	1996	1996: Q3	1996: Q4	1997: Q1	Most recent	
Real gross domestic product	2.3	1.5	3.3	2.9	3.4	–	
GDP excluding inventories	2.0	2.3	0.6	0.3	5.8	–	
Final domestic demand	0.6	2.5	4.4	7.5	6.6	–	
Government expenditure	-0.3	-1.9	-4.2	-0.7	-0.2	–	
Consumer expenditure	1.4	2.4	2.0	5.6	5.2	–	
Residential investment	-15.1	11.5	19.6	22.9	12.4	–	
Business fixed investment	5.2	6.6	25.1	23.4	20.5	–	
Non-residential construction	-5.6	-3.2	0.0	5.8	6.9	–	
Machinery and equipment	10.9	11.0	36.8	30.7	25.7	–	
Business inventory change [1]	0.3	-0.8	2.7	2.6	-2.2	–	
Trade balance [1]	1.2	-0.2	-3.7	-7.5	-0.6	–	
Exports	12.0	4.5	8.6	-10.1	23.2	–	
Imports	8.7	5.1	18.8	7.4	23.8	–	
Current account balance (nominal)	-7.4	3.8	6.3	-2.2	-4.9	–	
(percentage of GDP)	-1.0	0.5	0.8	-0.3	-0.6	–	
Real personal disposable income	1.1	-0.2	-1.4	0.8	-1.5	–	
Profits before taxes	13.1	0.2	50.6	19.3	16.9	–	
Costs and Prices (%, y/y)							
GDP price deflator	1.5	1.3	1.1	1.6	2.0	–	
Consumer price index	2.1	1.6	1.4	2.0	2.1	1.7	Apr-97
CPI – excluding food and energy	2.2	1.5	1.3	1.5	1.7	1.8	Apr-97
Unit labour costs	0.8	1.3	0.8	1.1	0.8		
Wage settlements (total)	0.9	0.9	1.2	1.6	1.5	1.6	Mar-97
Labour market							
Unemployment rate	9.5	9.7	9.8	9.9	9.6	9.5	May-97
Employment growth (%, a.r.)	1.6	1.3	0.6	1.4	1.1	5.5	May-97
Financial markets (average)							
Exchange rates (average)	72.88	73.34	72.99	74.06	73.61	72.61	June 5-97
Prime interest rate	8.65	6.06	5.92	4.83	4.75	4.75	June 5-97

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

lowest level in the post-Second World War period but near rates in the early 1960s when inflation and interest rates were similar to current levels.

Another factor underlying the low savings rate is that the national accounts underestimate funds actually available to households. For example, capital gains on equity and bond holdings are not included in income, but they are an important part of net personal wealth that continues to grow and to drive consumer spending.

Investment growth remains strong

Business non-residential investment jumped more than 20% for the third consecutive quarter. Within that category, machinery and equipment investment soared more than 25% for the third consecutive time. Non-residential construction rose about 7% after increasing nearly 6% in the previous quarter.

Residential investment continued to respond to lower interest rates as well, rising 12.4%, the fifth consecutive large quarterly gain. This was mainly in new residential construction, as housing starts rose significantly. Alterations and improvements also grew noticeably. However, overall growth in residential activity was restrained by a sharp drop in transfer costs (real estate commissions), as home resales fell off their record levels of late 1996.

Inventories restrain growth

Inventory accumulation by business was only about a third of its level in the previous quarter, thereby acting to restrain output growth. With sales rising noticeably, the economy-wide inventory-to-sales ratio fell to its lowest recorded level, suggesting demand increases in the near term are more likely to translate directly into production gains.

Exports rebound but imports grow faster

Foreign demand for Canadian products rose sharply, as real exports rebounded strongly from their fourth-quarter decline. Much of this was in automotive products, where exports rose as U.S. motor vehicle sales increased significantly and Canadian production rebounded from the GM strike in October 1996.

But import volumes continued to grow strongly along with domestic demand for import-intensive items like machinery and equipment and motor vehicles. With import growth actually exceeding that of exports, the real trade deficit on goods and services worsened by about $1 billion.

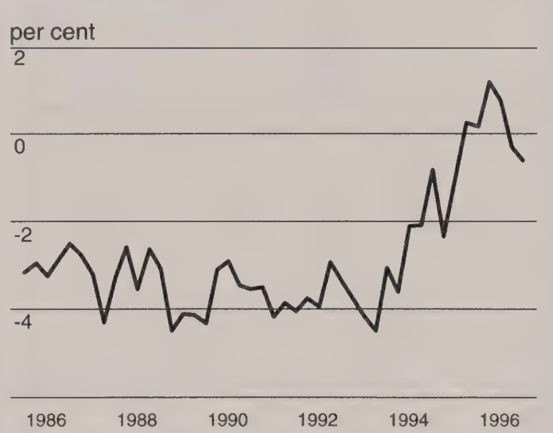
Current account posts small deficit

The current account deficit increased to $4.9 billion or 0.6% of nominal GDP from a deficit of $2.2 billion in the last quarter of 1996 (Chart 2). These deficits followed four consecutive quarterly surpluses (and a surplus for 1996 as a whole, the first annual surplus since 1982). The main reason for the deterioration in the first quarter was a $2.9 billion decline in the net investment income balance, driven by the profitability of foreign-owned firms on their Canadian operations. But that increased outflow was partly offset by smaller net interest payments, attributable to both lower interest rates and reduced borrowing from abroad.

Prices, costs and profitability

With the economy still operating below potential output, underlying price and cost pressures remain quite low. The implicit price index for GDP (Canada's broadest inflation measure) rose 1.5% in the first quarter, following a rise of 2.5% in the fourth. This brought the four-quarter increase to 2.0%.

Chart 2
Current account balance as a share of GDP



Unit labour costs declined 0.6% in the quarter, after rising 3.6% in the fourth. On a year-over-year basis, unit labour costs were up 0.8% in the first quarter.

Corporate profits surged another 17% in the quarter, for a fourth consecutive increase. Gains in the quarter were concentrated in the automotive sector, spearheaded by strong domestic demand and rebounding exports. The share of corporate profits in GDP rose to 8.8% – the highest level since mid-1989 but below the shares in the 1980s.

Employment perks up

The benefits of low interest rates are finally spilling over into the labour market. With 61,000 net new jobs created in May, employment in that month was 156,000 more than in February, the largest three-month gain since 1989 (Chart 3). These new jobs were mostly full time and in the private sector.

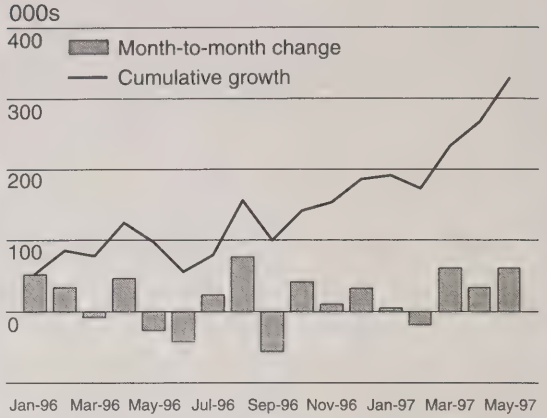
With job creation picking up in recent months, so too has participation in the labour market. As a result, the 9.5% unemployment rate in May was only modestly below the rate in February.

Second quarter indicators

Available indicators for the second quarter are mixed but positive on balance. The most important indicator, employment growth, is strongly positive. Average employment in April and May was about 3% above the first-quarter monthly average. Motor vehicle production and department store sales in April were also above their first-quarter monthly averages.

On the negative side, available data show both house resales and housing starts to date in the second quarter have slipped below their first-quarter averages.

Chart 3
Employment growth in 1996 and 1997



Interest rates remain low

Fiscal restraint, by both the federal and provincial governments, a near balance in the current account, low inflation and output below potential have helped to keep Canadian interest rates low. Since early 1995, short rates have fallen over 5 percentage points while long rates are down more than 3 percentage points. Indeed, since late 1996, short rates have been at levels last seen some 35 years ago.

The negative spreads between Canadian and U.S. yields on bonds with maturities up to 10 years are now quite firmly entrenched and 30-year bond yields have moved close to parity as well. On 3-month Treasury bills, the negative spread remains near 2 percentage points.

The Canadian dollar, despite brief periods of volatility, continues to trade in the 72 to 74 cents U.S. range seen for most of the last two years, despite these large negative interest-rate spreads.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 1997

KEY MESSAGES

- Real GDP growth accelerated to 4.9% in the second quarter of 1997, its strongest pace since the end of 1994. With four consecutive quarters of solid growth, output is now 3.7% above its year-earlier level.
- Much of the strength was in interest-sensitive expenditures, where previous declines in interest rates are fuelling significant gains, particularly in consumer durables and in residential and non-residential investment.
- Significantly adding to growth was a substantial increase in inventory investment.
- The current account deficit widened as stronger domestic demand increased imports at a faster pace than foreign demand increased exports.
- So far in 1997, over 260,000 net new jobs have been created. All were in the private sector and roughly two-thirds were full-time.
- Interest rates remain well below their levels in early 1995. The negative spread between Canadian and U.S. Treasury bill rates exceeds 2 percentage points and negative spreads have extended to 30-year bonds.

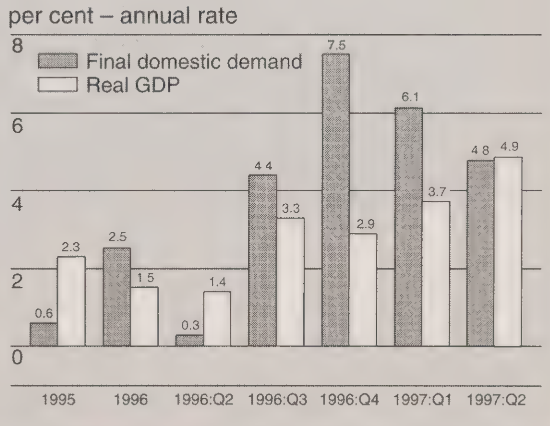
SUMMARY[1]

Final domestic demand – spending by households, business and government on goods and services and capital formation – rose 4.8% in the second quarter of 1997 (Chart 1), propelling real GDP growth to its best gain since 1994. Interest-sensitive spending on housing, automotive products, furniture and appliances and non-residential investment all surged yet again. In the last year, final domestic demand has risen 5.7%.

Also significantly adding to growth in the quarter was an apparently deliberate and sharp increase in inventory investment by business.

Domestic inflation and cost pressures remained subdued. Unit labour costs and the GDP implicit price index (the broadest measure of inflation in Canadian products) were both only modestly above their year-ago levels. The price index actually fell relative to its first-quarter level.

Chart 1
Growth in final domestic demand and real GDP



[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cutoff date for data in this document is noon, September 5, 1997.

Consumer spending growth remains strong

Real consumer expenditure again responded to low interest rates, increasing wealth and firming consumer confidence. Growth was strongest in the interest-sensitive categories. Spending on automotive products surged while that on furniture and appliances also jumped again, fuelled by increased housing activity.

Another factor supporting consumer spending was the sharpest increase in nominal personal disposable income in over two years. Solid employment gains in the quarter boosted earned income. But the even larger rise in nominal consumer spending pushed the personal savings rate down again to 0.9%.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1995	1996	1996: Q4	1997: Q1	1997: Q2	Most recent	
Real gross domestic product	2.3	1.5	2.9	3.7	4.9	–	
GDP excluding inventories	2.0	2.3	0.3	6.7	2.4	–	
Final domestic demand	0.6	2.5	7.5	6.1	4.8	–	
Government expenditure	-0.3	-1.9	-0.7	-1.4	0.5	–	
Consumer expenditure	1.4	2.4	5.6	5.0	4.6	–	
Residential investment	-15.1	11.5	22.9	10.1	10.6	–	
Business fixed investment	5.2	6.6	23.4	20.0	9.5	–	
Non-residential construction	-5.6	-3.2	5.8	6.7	10.4	–	
Machinery and equipment	10.9	11.0	30.7	25.1	9.2	–	
Business inventory change[1]	0.3	-0.8	2.6	-2.8	2.5	–	
Trade balance[1]	1.2	-0.2	-7.5	0.1	-2.7	–	
Exports	12.0	4.5	-10.1	23.6	2.8	–	
Imports	8.7	5.1	7.4	22.3	8.8	–	
Current account balance (nominal)	-7.4	3.8	-2.2	-3.4	-12.7	–	
(percentage of GDP)	-1.0	0.5	-0.3	-0.4	-1.5	–	
Real personal disposable income	1.1	-0.2	0.8	-2.2	1.5	–	
Profits before taxes	13.1	0.2	19.3	25.9	8.4	–	
Costs and Prices (%, y/y)							
GDP price deflator	1.5	1.3	1.6	1.7	0.9	–	
Consumer Price Index	2.1	1.6	2.0	2.1	1.6	1.8	Jul-97
CPI – excluding food and energy	2.2	1.5	1.5	1.7	1.8	1.5	Jul-97
Unit labour costs	0.8	1.3	1.1	0.9	0.5		
Wage settlements (total)	0.9	0.9	1.6	1.5	1.9	1.8	Jun-97
Labour market							
Unemployment rate	9.5	9.7	9.9	9.6	9.4	9.0	Aug-97
Employment growth (%, a.r.)	1.6	1.3	1.4	1.1	3.7	4.8	Aug-97
Financial markets (average)							
Exchange rates (average)	72.88	73.34	74.06	73.61	72.14	72.21	Sep 4-97
Prime interest rate	8.65	6.06	4.83	4.75	4.75	4.75	Sep 4-97

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Another factor underlying the low measured savings rate is that the national accounts underestimate the funds actually available to households. For example, capital gains on equity and bond holdings are not included in income, but they are an important part of personal wealth that continues to grow.

Investment growth continues

Business non-residential investment growth slowed from rates of 20% or more in the previous three quarters but remained impressive at 9.5%.

Especially important was that growth in non-residential construction accelerated to 10.4%, a third consecutive gain. Non-residential construction relies less on imports than spending on consumer durables or machinery and equipment investment, and thus gains there are more likely to spill over into overall economic growth and job creation. Much of the gain was in engineering construction in the oil and gas industry but there was also an increase in building construction. This is consistent with the upward revision to investment intentions in the Private and Public Investment Intentions Survey, which suggests further gains are likely in the second half.

Machinery and equipment investment rose another 9.2%, leaving it 25% higher than a year earlier.

Residential investment continued to respond to low interest rates, recording a sixth consecutive large quarterly gain. Despite a drop in housing starts in the second quarter, growth in housing construction remained strong, reflecting the strong rise in starts in the first quarter. Alterations and improvements also grew noticeably. But overall growth in residential activity was restrained by a drop in transfer costs (real estate commissions), as home resales fell for the second quarter in a row.

Inventory jump boosts growth

Inventory accumulation by business was eight times its level in the previous quarter, boosting output sharply (Chart 2). This appears to have been largely deliberate. With surging sales in the second quarter, the economy-wide inventory-to-sales ratio remained largely unchanged from the low level reached in the first quarter. Indeed, Statistics Canada's July Business Conditions Survey indicated that manufacturers are increasingly concerned about low inventories.

This suggests that further demand increases in the near term are likely to translate directly into production gains.

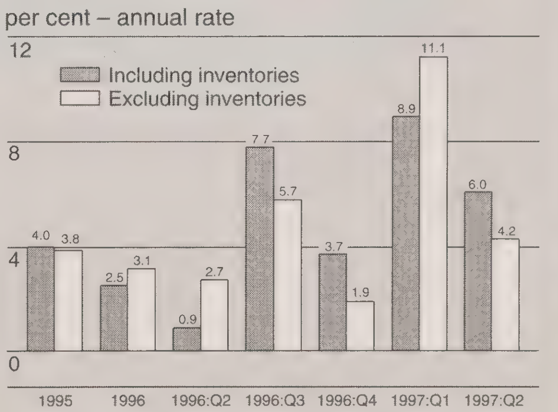
Exports rise modestly but imports jump

Rising foreign demand for Canadian products did boost exports modestly, although assembly problems played a role in restricting exports of automotive products. But import volumes continued to grow robustly, reflecting the strength in domestic demand in import-intensive areas like machinery and equipment investment and motor vehicles. With import growth exceeding that of exports, the real trade deficit on goods and services worsened by $4.3 billion.

Current account posts larger deficit

The current account deficit increased to $12.7 billion or 1.5% of nominal GDP from a deficit of $3.4 billion in the first quarter. This reflected both the widening of the real trade deficit in goods and a deterioration in the terms of trade, as the average price of imports rose while that of exports fell. The decline in the goods balance was partly offset by smaller deficits in services and investment income.

Chart 2
Growth in total demand, including and excluding inventories*



* Total demand equals final domestic demand plus exports plus inventory investment.

Prices, costs and profitability

With the economy still operating below potential, underlying price and cost pressures remain subdued. The implicit and chain price indices for GDP (Canada's broadest inflation measures) actually fell in the quarter, following modest rises in the first. This kept their four-quarter increases to less than 1.0%.

Unit labour costs were unchanged in the second quarter, after dropping in the first. On a year-over-year basis, unit labour costs were up only 0.5%.

Corporate profits jumped for a fifth consecutive quarter, to 9.1% of GDP. Higher profits have been a key source of the funds needed by firms for their increased investments in plant and equipment.

Strong employment growth

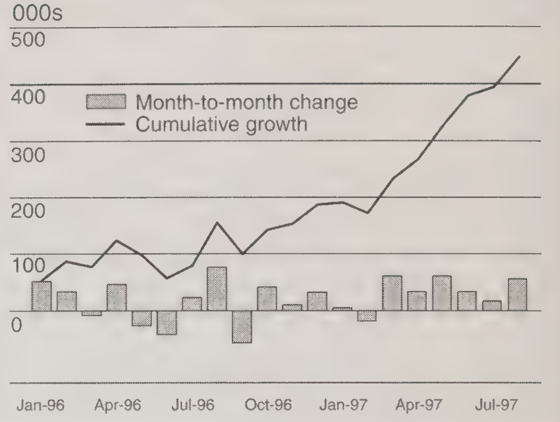
The benefits of low interest rates have spilled into the labour market. So far in 1997, over 260,000 net new jobs have been created. These were all in the private sector and roughly two-thirds were full-time. In addition, youth employment is up 52,000 since May.

With the participation rate in the labour market remaining quite steady, the unemployment rate in August was down to 9.0% from 9.7% in December 1996.

Third-quarter indicators

Available indicators for the third quarter are positive on balance. The most important indicator, employment growth, is strongly positive. With August's strong growth, even no further job gains in September would leave third-quarter employment roughly 3% above that in the second. Also, preliminary estimates show July motor vehicle sales and house resales at levels noticeably above their second-quarter averages. On the down side, despite rising in July, housing starts were below their second-quarter average.

Chart 3
Employment growth in 1996 and 1997



Interest rates remain low

Canadian interest rates remain low because of fiscal restraint by federal and provincial governments, low inflation and continuing slack in the economy. Despite the recent oscillation, short rates continue to be over 5 percentage points lower than in early 1995 while long rates are down more than 3 percentage points. Short rates, on average this year, have been at their lowest since the early 1960s.

On 3-month Treasury bills, the negative spread between Canadian and U.S. rates exceeds 2 percentage points and negative spreads have extended to bonds with 30-year maturities.

In recent months, the Canadian dollar has generally traded between 71½ and 73 cents U.S.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre (613) 995-2855. For other inquiries about this publication, contact Jeremy Rudin (613) 992-2370.
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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JANUARY 1998

KEY MESSAGES

- In the third quarter of 1997, real GDP grew a solid 4.1% at an annual rate. While this was off the rapid 5.4% pace set in the previous quarter (revised up from the initial estimate of 4.9%), it represents the fifth consecutive quarter of solid growth, averaging 4.0%.
- Robust domestic demand has been the main source of growth, with much of the strength coming from the positive impact of low interest rates on spending.
- Strong foreign demand raised exports. But as Canadian demand growth outpaced that of our major trading partners, and was especially strong in import-intensive goods, import growth far outpaced export growth. As a result, the trade balance fell sharply and the current account deficit widened.
- In 1997, 363,000 net new jobs were created. All were in the private sector and all were full-time.

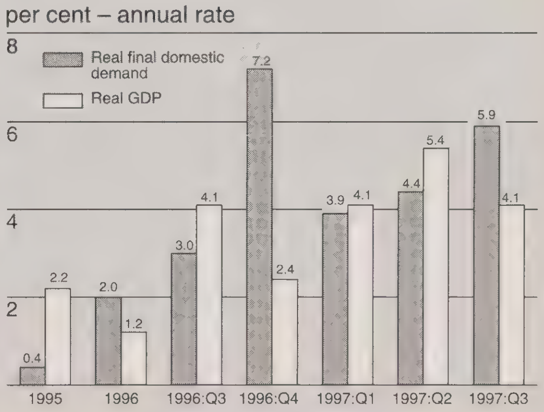
SUMMARY[1]

Strong Canadian demand again boosted growth in the third quarter. Final domestic demand – spending by households, business and government on goods, services and capital formation – rose 5.9% (Chart 1). Much of the strength was in interest-sensitive expenditures, with low interest rates fuelling strong gains in business investment in plant and equipment and consumer spending on durable and semi-durable goods.

But this demand surge was especially strong for import-intensive goods such as machinery and equipment and consumer durables and this leakage moderated the gain in production.

Domestic cost and inflation pressures remained subdued. Unit labour costs and the GDP implicit and chain price indices (the broadest measures of inflation in Canadian products) were all only modestly above their year-earlier levels.

Chart 1
Growth in real final domestic demand and real GDP



1 Unless otherwise noted, data and per cent changes are quoted at annual rates. The cutoff date for data in this document is end of day, January 9, 1998.

Consumer spending growth remains strong

Real consumer expenditure growth once again was robust, with the strongest gains in semi-durables, such as clothing and footwear, and in durables, such as recreational equipment and household furnishings and appliances. Consumers have responded positively to low interest rates, increasing wealth, rising employment and thus increased real disposable income. With solid employment gains boosting wage income, the gain in real personal disposable income in the third quarter was double that in the second quarter and the best since the end of 1995.

Main economic indicators
(per cent changes at annual rates or per cent levels, unless otherwise indicated)

	1995	1996	1997:Q1	1997:Q2	1997:Q3	Most recent	
Real gross domestic product[1]	2.2	1.2	4.1	5.4	4.1	–	
GDP excluding inventories	1.6	2.1	7.0	2.5	3.6	–	
Final domestic demand	0.4	2.0	3.9	4.4	5.9	–	
Government expenditure	-0.5	-1.5	-1.3	1.1	1.2	–	
Consumer expenditure	1.7	2.4	3.9	4.5	5.3	–	
Residential investment	-14.1	10.9	11.4	10.6	-2.3	–	
Business fixed investment	3.0	4.2	12.7	8.2	24.5	–	
Non-residential structures	-0.7	4.3	7.9	10.8	11.6	–	
Machinery and equipment	5.9	4.2	16.4	6.4	34.4	–	
Business inventory change[2]	0.6	-0.9	-2.8	2.9	0.5	–	
Trade balance[2]	0.9	0.3	2.5	-1.8	-3.0	–	
Exports	9.3	5.7	26.9	2.7	10.1	–	
Imports	6.7	5.2	19.3	8.1	19.9	–	
Current account balance (nominal)	7.6	-3.7	3.3	14.3	23.0	–	
(percentage of GDP)	1.0	-0.4	0.4	1.7	2.7	–	
Real personal disposable income	2.0	-0.1	-3.0	0.8	1.7	–	
Profits before taxes	18.3	-3.4	26.9	6.6	20.2	–	
Costs and Prices (%, y/y)							
GDP implicit price deflator	2.6	1.4	1.5	0.8	0.4	–	
Consumer price index	2.1	1.6	2.1	1.6	1.7	0.9	Nov-97
CPI – excluding food and energy	2.2	1.5	1.7	1.8	1.5	0.9	Nov-97
Unit labour costs	1.2	1.3	0.8	0.1	0.2		
Wage settlements (total)	0.9	0.9	1.3	1.8	1.3	1.7	Oct-97
Labour market							
Unemployment rate	9.5	9.7	9.6	9.4	9.0	8.6	Dec-97
Employment growth (%, a.r.)	1.6	1.3	1.1	3.7	3.3	5.4	Dec-97
Financial markets (average)							
Exchange rates (average)	72.88	73.34	73.61	72.14	72.21	69.92	Jan 9-98
Prime interest rate	8.65	6.06	4.75	4.75	4.75	6.00	Jan 9-98

1 Historical revisions have changed the levels and composition of gross domestic product but left the aggregate growth rate broadly similar.

2 Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Nominal consumer spending rose even faster than disposable income, pushing the personal savings rate down again to 1.5%, its lowest recorded level (Chart 2). However, this low savings rate partly reflects the fact that the National Accounts income measure does not include some wealth increases such as capital gains on equity and bond holdings. This is relevant because such wealth has been growing and boosting spending.

Investment growth strengthens

Business investment in plant and equipment increased 24.5%, the fifth consecutive quarter of strong growth. Low interest rates, rising profits and strong equity markets have improved businesses' ability to invest at the same time as an increased rate of capacity utilization had created a need for new investment. The rate of capacity utilization in non-farm sectors rose to 86.2% in the third quarter, its highest rate since the 86.8% in 1988 and more than four percentage points above its historical average.

Machinery and equipment investment accelerated sharply to 34.4% in the third quarter from 6.4% in the second to reach 23.1% above its level of a year earlier. Especially important was that growth in non-residential structures accelerated to 11.6% to stand 11.5% above its level a year earlier. Investment in such structures, unlike machinery and equipment investment and spending on consumer durables, has little leakage to import. Thus, gains there are more likely to spill over into overall economic growth and job creation.

But residential investment fell 2.3% after six consecutive large quarterly gains. Despite a rise in housing starts in the third quarter, growth in new housing construction fell as the drop in starts in the second quarter led to less construction activity in the third. Growth was also restrained by falling real estate commissions. However, alterations and improvements grew strongly.

Inventory increase boosts growth

Business inventory accumulation increased by almost $1 billion in the third quarter. This contributed to growth but much less than did the larger increase in accumulation in the second quarter. This inventory build-up appears to have been deliberate, as surging sales have reduced the economy-wide inventory-to-sales ratio to an all-time low. That suggests that further demand increases in the near term are likely to translate directly into production gains.

Exports jump but imports soar

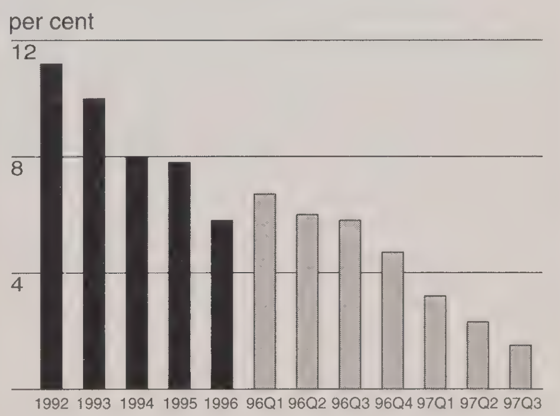
Strong foreign demand for Canadian products sharply boosted exports in the third quarter. But as Canadian demand growth outpaced that of our major trading partners, and was especially strong in import-intensive goods, total import growth far outpaced export growth (19.9% versus 10.1%) and the real trade balance fell sharply by $6 billion (1992 dollars).

Prices, costs and profitability

With the economy still operating below potential, underlying price and cost pressures remain subdued. The conventional implicit price index for GDP fell 0.4% in the third quarter, a third consecutive decline that left it only 0.4% above its level of a year earlier. The chain price index (Statistics Canada's preferred indicator) shows more inflation, but still rose to only 1.1% above the year-earlier level.

Unit labour costs were down 0.4% in the third quarter, after falling 1.0% in the second. On a year-over-year basis, unit labour costs were up only 0.2% in the third quarter, aided by solid gains in productivity.

Chart 2
The personal savings rate



Pre-tax corporate profits increased 20.2% in the third quarter, the fifth consecutive quarterly gain. This raised the share of corporate profits in GDP to 9.6% – the highest level in eight years. The gains were led by rebounding profits in the petroleum and natural gas and automotive sectors. These higher profits have helped business to finance investments in plant and equipment.

Current account posts larger deficit

The current account deficit increased to $23 billion or 2.7% of nominal GDP from a deficit of $14.3 billion in the second quarter. This reflected both the widening of the real trade deficit in goods, a slight deterioration in the terms of trade (as the average price of imports fell less than did the average price of exports) and a worsening in the investment income balance by about $2.7 billion.

Strong employment growth

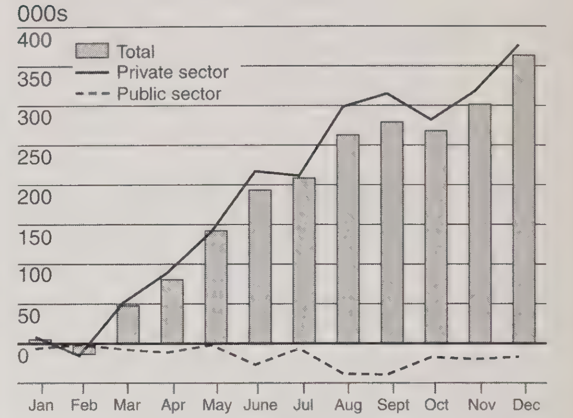
The benefits of low interest rates have spilled into the labour market. During 1997, 363,000 net new jobs were created (Chart 3). These were all in the private sector and all were full-time. The year ended on a strong note, with 111,000 full-time jobs created in December.

The unemployment rate in December was 8.6%, down from 10% in late 1996 and the lowest level since September 1990. And since late 1996, the unemployment rate has fallen in every province.

Fourth quarter indicators

Available indicators to date for the fourth quarter are mixed but generally positive. The most important indicator is employment growth and it shows employment in the fourth quarter was 0.4% (quarterly rate) above that in the third quarter. Current estimates of housing starts, manufacturing shipments, motor vehicle production, and motor vehicle and department store sales, and overall real output all point to continued growth at this time. But house resales and exports appear to be restraining growth.

Chart 3
Cumulative employment growth during 1997



Interest rates rise but remain low

Canadian short-term interest rates have risen about 130 basis points since mid-September, coinciding with downward pressure on the value of the Canadian dollar that partly reflects the uncertainty in world financial markets given developments in Asia. But rates remain low by historical standards because of fiscal restraint by federal and provincial governments, low inflation and continuing slack in the economy. Short and long rates both continue to be around 4 percentage points lower than in early 1995.

On 3-month Treasury bills, the negative spread between Canadian and U.S. rates has narrowed to around 1 percentage point. Negative spreads with U.S. rates still extend, at times, to bonds with 30-year maturities.

Recently, the Canadian dollar has been trading near 70 cents U.S.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE MARCH 1998

KEY MESSAGES

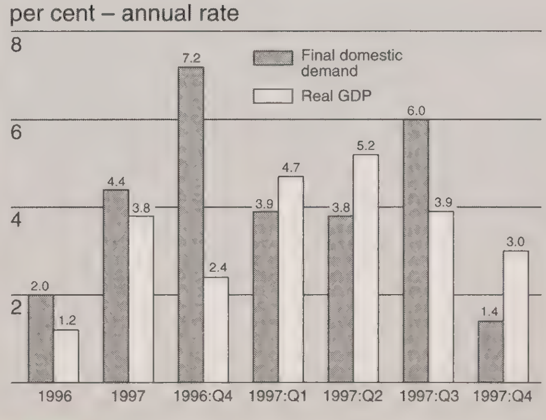
- In the fourth quarter of 1997, real GDP grew 3.0% at an annual rate. While somewhat off the pace of the previous three quarters, this sixth consecutive solid gain left output up 4.2% from a year earlier. For 1997 as a whole, real GDP grew 3.8%, up sharply from 1.2% in 1996.
- Real exports continued to grow strongly, reflecting strong foreign demand. Further, Canadian households sharply boosted their demand for durable goods, notably motor vehicles, new houses and renovations, as the low interest rate environment continued to encourage "big ticket" purchases.
- However, other components of domestic demand fell, slowing overall growth. Consumer spending excluding durables declined, as did business investment in plant and equipment.
- Slower growth in domestic demand was mirrored in slower real import growth. But with import prices rising faster than export prices, the overall nominal trade surplus declined.
- Nonetheless, the current account deficit narrowed, as an improvement in the investment income deficit more than offset the weakening in the nominal trade surplus.
- A gain of 82,000 jobs in February brought the number of net new jobs created since the end of 1996 to 453,000. The entire gain, both in February and since the end of 1996, was in the private sector and full time. The unemployment rate in February was 8.6%, the lowest since September 1990.

SUMMARY[1]

Strong foreign demand boosted output in the fourth quarter. However, growth in final domestic demand – spending by households, businesses and government on goods, services and capital formation – moderated to 1.4% from 6.0% in the third quarter (Chart 1). Much of the domestic gain was in interest-sensitive expenditures by households. Business investment in plant and equipment fell in the quarter after five consecutive quarters of strong growth.

Domestic cost and inflation pressures remained very subdued according to all national accounts measures. Indeed, unit labour costs fell throughout 1997.

Chart 1
Growth in real final domestic demand and real GDP



1 Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data in this document is noon, March 13, 1998.

Consumer spending growth slows

Real consumer expenditure growth slowed to 2.3% after four quarters of very strong growth. Spending on durable goods did jump 21.5%, with an especially large gain for motor vehicles, as manufacturers offered buyer incentives. But consumer expenditures on other types of goods actually fell, with unseasonably mild weather sharply reducing the need for energy consumption.

The spending slowdown occurred despite real personal disposable income rising 1.4% after having fallen 1.6% in the third quarter. Unincorporated business and net farm income jumped, and investment income grew after six consecutive declines. But smaller employment gains and work stoppages by Canadian postal workers and educators in Ontario slowed labour income growth.

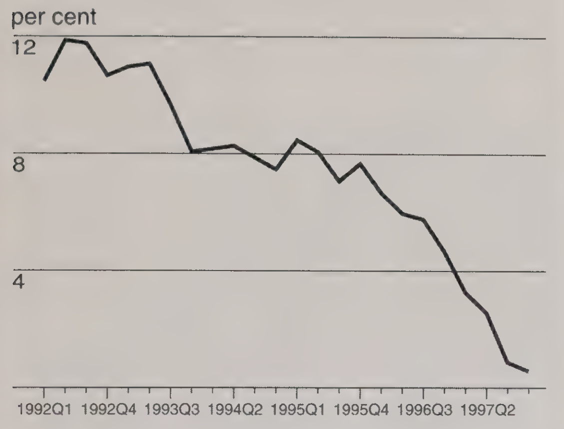
Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1996	1997	1997Q2	1997Q3	1997Q4	Most Recent	
Real gross domestic product	1.2	3.8	5.2	3.9	3.0	–	
GDP excluding inventories	2.1	3.1	1.9	3.4	3.2	–	
Final domestic demand	2.0	4.4	3.8	6.0	1.4	–	
Government expenditure	-1.5	-0.6	-0.2	1.6	-0.8	–	
Consumer expenditure	2.4	3.9	4.6	5.5	2.3	–	
Residential investment	10.9	13.1	10.9	-1.3	8.7	–	
Business fixed investment	4.2	14.5	4.6	23.0	-2.0	–	
Non-residential construction	4.3	9.1	7.0	10.7	-3.1	–	
Machinery and equipment	4.2	18.7	3.0	32.3	-1.3	–	
Business inventory change[1]	-0.9	0.7	3.2	0.6	-0.2	–	
Trade balance[1]	0.3	-1.4	-1.0	-3.4	0.8	–	
Exports	5.7	8.6	3.3	12.2	8.3	–	
Imports	5.2	13.4	6.4	23.8	6.0	–	
Current account balance (nominal $billion)	3.7	-17.0	-12.9	-26.5	-24.9	–	
(percentage of GDP)	0.4	-2.0	-1.5	-3.1	-2.9	–	
Real personal disposable income	-0.1	-0.7	1.0	-1.6	1.4	–	
Profits before taxes	-3.4	17.3	-12.2	32.9	22.3	–	
Costs and prices (%, y/y)							
GDP price deflator	1.4	0.5	0.6	0.4	-0.3	–	
Consumer Price Index	1.6	1.6	1.6	1.7	1.0	1.1	Jan-98
CPI – excluding food and energy	1.4	1.6	1.8	1.5	1.1	1.2	Jan-98
Unit labour costs	1.3	0.0	0.0	0.2	-0.9		
Wage settlements (total)	1.0	1.6	1.8	1.4	1.6		
Labour market							
Unemployment rate (%)	9.7	9.2	9.4	9.0	8.9	8.6	Feb-98
Employment growth	1.3	1.9	3.5	3.3	1.8	7.2	Feb-98
Financial markets (average)							
Exchange rate (cents U.S.)	73.34	72.24	72.14	72.21	70.99	70.90	Mar 12-98
Prime interest rate (%)	6.06	4.96	4.75	4.75	5.58	6.50	Mar 12-98

1 Annualized change expressed as a percentage of GDP in the previous period.

Source: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
The personal savings rate



Over the four quarters of 1997, nominal personal spending rose 5.5% but personal disposable income rose only 0.9%. As a result, the personal savings rate fell to 0.6%, its lowest recorded level (Chart 2). However, this low savings rate partly reflects the fact that the national accounts income measure does not include some wealth increases such as capital gains on equity and bond holdings. This is relevant because such wealth rose during 1997, helping support spending.

Business investment slips

Business investment in plant and equipment slipped 2.0% in the fourth quarter after five consecutive strong gains.

Machinery and equipment investment dipped 1.3% after soaring over 30% in the third quarter, leaving it still 12.4% above its level of a year earlier. Investment in non-residential structures fell 3.1% because of a sharp drop in engineering projects as Hibernia was completed. But investment in non-residential buildings continued to rise sharply, increasing another 11.4%.

Residential investment rose 8.7% following a drop in the third quarter. New housing construction rose despite housing starts in the quarter being basically unchanged, as activity spilt over from the third quarter. Alterations and improvements also grew strongly but lower house resales reduced real estate commissions.

Inventory growth continues

Total business inventory accumulation eased slightly but remained quite high. Indeed, real non-farm business inventories have increased some $26.4 billion over the last three quarters. However, rising sales have kept the economy-wide inventory-to-sales ratio near its all-time low. With Statistics Canada's January *Quarterly Survey of Business Conditions* showing most manufacturers feeling inventory levels are not excessive, this suggests further demand increases in the near term are likely to translate directly into production gains.

Exports outjump imports

Strong foreign demand for Canadian products boosted real exports 8.3%, to a level 11.9% higher than a year earlier. With Canadian domestic demand lagging, import growth fell short of export growth and the real trade surplus rose $1.7 billion (1992 dollars).

Subdued price and cost increases propel profits upward

With the economy still operating below potential, underlying price and cost pressures remained very subdued in the fourth quarter. Aided by solid gains in productivity, unit labour costs fell for the fourth consecutive quarter to a level 0.9% lower than a year earlier.

Meanwhile, the implicit price index for GDP was 0.3% below its level of a year earlier after a 0.4% increase in the quarter. This year-over-year decline in the GDP deflator was largely due to weakening export prices during most of 1997, a reflection of softening commodity prices.

Pre-tax corporate profits surged 22.3% in the fourth quarter, the fifth large quarterly gain in the last year-and-a-half. This raised the share of corporate profits in GDP to 9.8% – the highest level in nearly nine years. The gains were most notable in the petroleum, natural gas, transportation and telecommunications sectors.

Current account posts smaller deficit

The current account deficit narrowed $1.6 billion to $24.9 billion, or 2.9% of nominal GDP. This reflected a $5.1 billion improvement in the investment income balance. This more than countered a deterioration in the nominal trade surplus caused by falling terms of trade. Weakening commodity prices restrained the growth in the average price of exports in the quarter while the average price of imports rose, partly reflecting the decline in the value of the Canadian dollar.

Employment situation is positive

The solid fundamentals of the Canadian economy are reflected in the labour market. With a gain of 82,000 in February, the number of net new jobs created since the end of 1996 has risen to 453,000. All were full time and in the private sector (Chart 3). The unemployment rate, at 8.6% in February, was the same as in December 1997 and the lowest rate since September 1990.

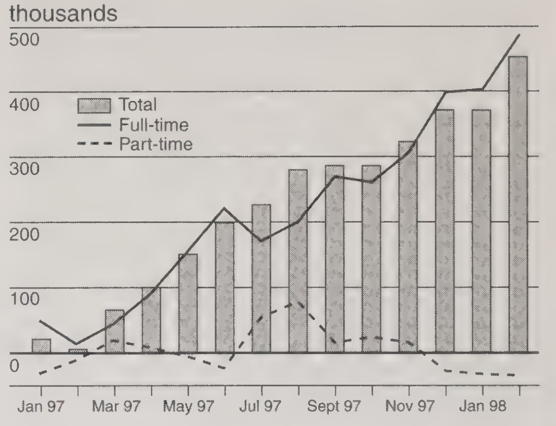
Interest rates rise but remain low

Canadian short-term interest rates have risen more than 1½ percentage points since the end of September, an increase coinciding with a decline in the value of the Canadian dollar to an all-time low of 68.10 cents U.S. on January 29. This partly reflected uncertainty in world financial markets given developments in Asia in the fourth quarter. But rates remain low by historical standards, reflecting fiscal restraint by federal and provincial governments, low inflation and continuing slack in the economy. Short-term rates are over 3½ percentage points lower than in early 1995 while long rates continue to be more than 4 percentage points lower.

On 3-month Treasury bills, the negative spread between Canadian and U.S. rates has narrowed but remains more than ½ percentage point. And interest rate spreads with U.S. rates remain negative across the entire maturity spectrum.

Recently, the dollar has recovered and has been trading near 71 cents U.S.

Chart 3
Cumulative employment growth since 1996



First quarter indicators

Available indicators to date for the first quarter are scarce and distorted because of the January ice storm in Ontario, Quebec and the Maritime provinces.

But employment data show continued strong growth. Even if March employment were unchanged from that in February, employment growth in the first quarter would be 0.7% (quarterly rate).

Another positive development, for 1998 as a whole, is that the *Private and Public Investment Intentions Survey* released in February suggests that private-sector investment will record a fifth consecutive year of healthy growth in 1998, though the rate of growth is projected to slow substantially from last year's very rapid pace.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 1998

KEY MESSAGES

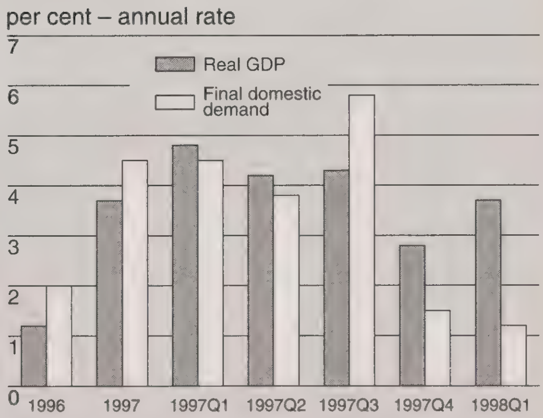
- In the first quarter of 1998, real GDP grew at an annual rate of 3.7%, up from 2.8% in the fourth quarter, despite the disruption caused by the ice storm in central and eastern Canada in January. This was the seventh consecutive quarter of solid growth, averaging 3.8%.
- Real personal disposable income surged 7.2%, its sharpest rate of growth since 1992.
- Growth in real exports remained strong and so continued to raise domestic production, but not as robustly as in the fourth quarter.
- A shift in domestic demand toward goods and services produced in Canada and away from import-intensive products boosted the growth rate of domestic production. In particular, business investment in buildings and engineering projects (such as roads, pipelines, transmission lines and oil and gas well drilling) jumped as did consumer spending on services. Meanwhile, demand fell for import-intensive products like consumer durables and machinery and equipment. This reduced imports and held growth in final domestic demand to 1.2%.
- With real exports rising and real imports falling, the real trade balance improved $5 billion. But a terms-of-trade deterioration moderated the gain in the nominal trade balance. Nonetheless, trade contributed to an improvement of over $3 billion in the current account deficit (to 1.8% of GDP).
- Strong growth has boosted the number of people with jobs by 164,100 during 1998, despite modest losses in May. The unemployment rate in May was 8.4%, the same as in April and the lowest level since 1990.

SUMMARY[1]

While growth in final domestic demand (that is, spending by households, businesses and government) slowed in the first quarter, a shift in spending toward Canadian-made products and away from foreign products boosted output growth (Chart 1). A drop in imports, when combined with continuing strong exports, raised the trade balance.

Domestic cost and inflation pressures remained very subdued according to all national accounts measures.

Chart 1
Growth in real GDP and real final domestic demand*



* Final domestic demand is the sum of consumer spending, business fixed investment and government spending.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, June 5, 1998.

Consumers switch to Canadian products and save more of their rising incomes

Real consumer expenditure growth slowed slightly to 2.6% in the first quarter. Demand shifted toward domestic-made products. Spending increased in all major categories except durables, with the growth rate of spending on services rising to 4.9% from 1.7% in the fourth quarter. Spending on durable goods, which are generally more import intensive, fell 9.3% after having risen 21.5% in the previous quarter when dealer incentives sharply boosted spending on motor vehicles (Chart 2).

Personal disposable income rose 7.2%, its sharpest pace since 1992. Labour income bounced up 6.0%, its best pace since 1994.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1996	1997	1997Q3	1997Q4	1998Q1	Most Recent	
Real gross domestic product	1.2	3.7	4.3	2.8	3.7	–	
GDP excluding inventories	2.1	2.9	3.4	1.4	4.4	–	
Final domestic demand	2.0	4.5	5.8	1.5	1.2	–	
Government expenditure	-1.5	-0.7	1.7	-1.4	-0.4	–	
Consumer expenditure	2.4	4.1	5.0	2.7	2.6	–	
Residential investment	10.9	13.1	-1.3	8.7	-0.9	–	
Business fixed investment	4.2	14.5	23.0	-2.0	-1.5	–	
Non-residential construction	4.3	9.1	10.7	-3.1	19.5	–	
Machinery and equipment	4.2	18.7	32.3	-1.3	-14.1	–	
Business inventory change[1]	-0.9	0.8	0.9	1.5	-0.6	–	
Exports	5.7	8.0	13.6	7.3	5.9	–	
Imports	5.2	13.3	23.6	9.2	-0.8	–	
Current account balance							
(BOP basis, nominal $ billion)	4.5	-12.8	-21.7	-18.7	-15.4	–	
(percentage of GDP)	0.6	-1.5	-2.5	-2.2	-1.8	–	
Real personal disposable income	-0.1	-0.7	-2.2	0.0	7.2	–	
Profits before taxes	-3.4	16.2	31.4	14.8	-23.8	–	
Costs and prices (%, y/y)							
GDP price deflator	1.4	0.5	0.4	-0.3	-0.2	–	
Consumer Price Index	1.6	1.6	1.7	1.0	1.0	0.8	Apr-98
CPI – excluding food and energy	1.4	1.6	1.5	1.1	1.4	1.2	Apr-98
Unit labour costs	1.3	0.1	0.3	-0.7	0.1		
Wage settlements (total)	0.9	1.6	1.4	1.7	1.8	1.7	Mar-98
Labour market							
Unemployment rate (%)	9.7	9.2	9.0	8.9	8.6	8.4	May-98
Employment growth	1.3	1.9	3.3	1.8	3.0	-0.6	May-98
Financial markets (average)							
Exchange rates (cents U.S.)	73.34	72.24	72.21	70.99	69.92	68.76	June 4-98
Prime interest rates (%)	6.06	4.96	4.75	5.58	6.33	6.50	June 4-98

1 Annualized change expressed as a percentage of GDP in the previous period.

Source: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
Growth in real consumer spending by category

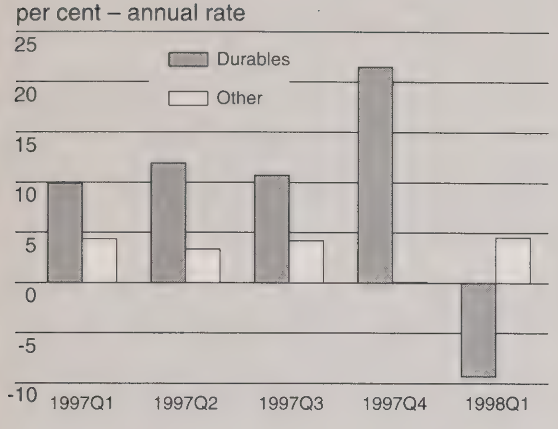
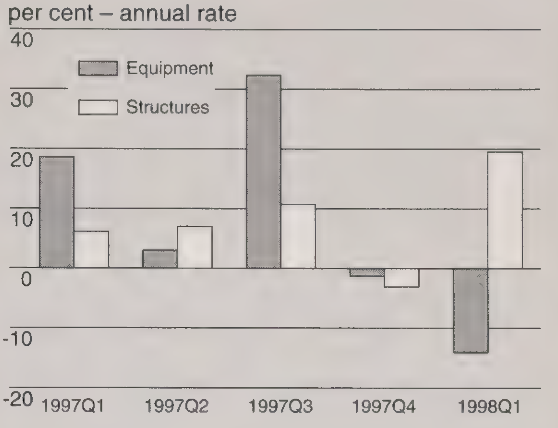


Chart 3
Growth in real business non-residential investment by category



This contrasted favourably with 1.8% growth in the fourth quarter when slower employment growth and work stoppages by Canadian postal workers and educators in Ontario slowed growth. Unincorporated business income continued to grow strongly. And investment income jumped for a second time after six consecutive declines. Personal transfers to government grew 4.0%, their slowest pace since the end of 1996, with personal income taxes rising only 1.2%.

With nominal disposable income growth exceeding that of nominal personal spending, the personal savings rate rose to 1.2% from a downwardly revised 0.1% in the previous quarter, its lowest recorded level.

Business investment growth remains stalled but moves closer to home

Business investment in plant and equipment fell 1.5% in the first quarter, a second consecutive decline. Machinery and equipment investment plunged 14.1% following a modest drop in the fourth quarter (Chart 3).

But investment in non-residential buildings and engineering projects, which is satisfied less by imports and so provides a stronger impetus to domestic production, rebounded sharply. After a modest loss in the fourth quarter, such investment resumed its strong growth of the previous two years and soared 19.5%. Investment in buildings registered a third consecutive sharp increase while that in engineering works rebounded from a fourth quarter decline.

Residential investment fell 0.9%, as lower resale activity sharply reduced transfer costs (primarily real estate commissions) by nearly 30%. But this was largely offset by other components of residential investment. New house construction rose 3.2%, in line with higher housing starts in the quarter, while alterations and improvements grew strongly.

Inventories slow

Total business inventory accumulation eased from $11.5 billion in the fourth quarter to a still strong $10.4 billion in the first quarter. Since this coincided with rising sales, the economy-wide inventory-to-sales ratio remained near its all-time low and well below levels in the early 1990s. With Statistics Canada's April Quarterly Survey of Business Conditions showing that most manufacturers judge inventory levels to be acceptable, this suggests that further demand increases in the near term are likely to translate directly into production gains.

Exports stay strong while imports fall

Strong foreign demand for Canadian products boosted real exports 5.9% in the first quarter, only modestly off the pace in the previous quarter despite problems in Asia. Slower domestic demand growth, and a shift in that demand, produced declines in spending on import-intensive consumer durables and business machinery and equipment. As a result, real imports dropped 0.8% and the real trade balance rose $5.0 billion (1992 dollars).

Current account posts smaller deficit

The current account deficit narrowed $3.2 billion to $15.4 billion, or 1.8% of nominal GDP. This reflected an improvement in the nominal balance on goods and services of over $4 billion that accompanied the gain in the real trade balance.

Inflation subdued while profits dive

With the economy still operating below potential, underlying price and cost pressures remained subdued in the first quarter.

The implicit price index for GDP was 0.2% below its level of a year earlier. This decline was largely due to weakening export prices, a reflection of softening commodity prices.

While unit labour costs rose 2.1% relative to their fourth quarter level, they were up only 0.1% from their level of a year earlier because of previous declines.

Pre-tax corporate profits slumped 23.8% in the first quarter to an 8.9% share of nominal GDP. This reflected the impact on profits of falling commodity prices and the insurance pay-outs associated with the ice storm. The drop in profits followed strong gains in five of the previous six quarters.

Employment situation is positive

The strong growth in the Canadian economy is also reflected in the labour market. Despite a modest loss in May, employment has risen by 164,000 jobs so far in 1998, boosting the number of net new jobs created since the end of 1996 to 536,000. Net job creation during those 17 months has been entirely in the private sector, with full-time jobs making up almost all of the gain. The unemployment rate was 8.4% in May, the same as in April and the lowest level since 1990.

Interest rates steady

Short-term interest rates are modestly above their level in early March, while long-term interest rates are modestly below. Rates remain low by historical standards, reflecting fiscal restraint by federal and provincial governments, low inflation and continuing slack in the economy. Short-term rates are about 3½ percentage points lower than their peak in early 1995 while long rates remain more than 4 percentage points lower.

On 3-month Treasury bills, the negative spread between Canadian and U.S. rates has narrowed but remains above ¼ percentage point. And interest rate spreads with U.S. rates remain negative across the entire maturity spectrum.

Recently, the dollar has been trading between 68 and 69 cents U.S.

Second quarter indicators show strength

The few indicators available to date suggest that the substantial momentum in the economy should yield further strong growth in the second quarter.

Average employment in April and May exceeded that in the first quarter by 0.8% (quarterly rate). Further, preliminary estimates show April's new motor vehicle sales, department store sales and house resales to be well ahead of their first quarter pace. Residential construction, however, seems to have weakened, as housing starts appear likely to decline in the second quarter.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 1998

KEY MESSAGES

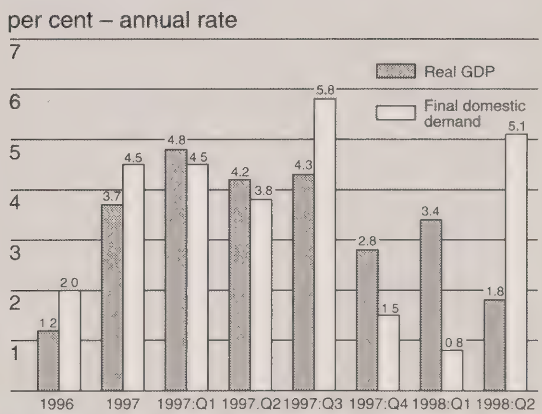
- In the second quarter of 1998, real GDP growth moderated to an annual rate of 1.8% from 3.4% in the first quarter.
- Final domestic demand growth strengthened sharply to 5.1% in the quarter, especially for import-intensive components like consumer durables and business machinery and equipment.
- The slowing in output growth primarily reflected a sharp slowdown in inventory accumulation plus a further moderation in still strong export growth and a domestic demand shift toward imports. Excluding inventories, real GDP rose 3.7%, only slightly off the first-quarter pace.
- With imports rising faster than exports, the trade surplus declined modestly. But the investment income deficit with non-residents fell, resulting in a small improvement in the overall current account.
- Employment growth was strong during the first four months of 1998 before easing back somewhat in May and June. Growth resumed in July and August despite the negative impact of the strike against General Motors in the United States. The unemployment rate in August was 8.3%.

SUMMARY[1]

Despite much stronger final domestic demand, overall economic growth slowed in the second quarter (Chart 1). This reflected a sharp slowdown in inventory accumulation, a further modest slowdown in export growth and a shift in spending toward foreign-made products.

Domestic cost and inflation pressures remained subdued.

Chart 1
Growth in real final domestic demand and real GDP



1 Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, September 4, 1998.

Consumers up their spending sharply

Real consumer expenditure growth jumped to 5.5% in the second quarter from 0.6% in the first. Spending shifted toward import-intensive durables, up 24.2% after having dropped 12.4% in the previous quarter. In particular, spending on motor vehicles soared, in part as a response to dealer incentives. Demand for non-durables and services also showed solid gains.

Personal income growth was 2.2% in the second quarter, compared to 6.0% in the first.

Labour income growth moderated sharply to less than half its pace in the first quarter despite similar employment growth in the two quarters. But unlike the first quarter, when full-time jobs more than accounted for the increase, about half of the employment gain in the second quarter came in part-time work. Growth in unincorporated business income was also more or less cut in half. But investment income did

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

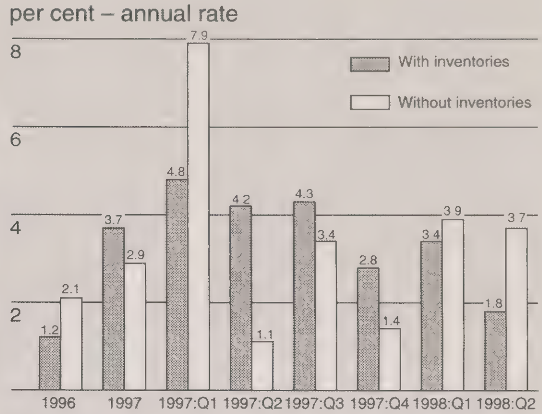
	1996	1997	1997Q4	1998Q1	1998Q2	Most Recent	
Real gross domestic product	1.2	3.7	2.8	3.4	1.8	–	
GDP excluding inventories	2.1	2.9	1.4	3.9	3.7	–	
Final domestic demand	2.0	4.5	1.5	0.8	5.1	–	
Government expenditure	-1.5	-0.7	-1.4	0.7	3.5	–	
Consumer expenditure	2.4	4.1	2.7	0.6	5.5	–	
Residential investment	10.9	13.1	8.7	-0.6	-6.4	–	
Business fixed investment	4.2	14.5	-2.0	2.7	11.5	–	
Non-residential construction	4.3	9.1	-3.1	14.2	7.2	–	
Machinery and equipment	4.2	18.7	-1.3	-4.7	14.6	–	
Business inventory change[1]	-0.9	0.8	1.5	-0.4	-1.8	–	
Trade balance[1]	0.3	-1.6	-0.6	2.3	-0.2	–	
Exports	5.7	8.0	7.3	6.3	5.3	–	
Imports	5.2	13.3	9.2	0.1	6.1	–	
Current account balance							
(BOP basis, nominal $ billion)	4.5	-12.8	-18.7	-17.1	-16.9	–	
(percentage of GDP)	0.6	-1.5	-2.2	-2.0	-1.9	–	
Real personal disposable income	-0.1	-0.7	0.0	5.5	-2.0	–	
Profits before taxes	-3.4	16.2	14.8	-29.3	-9.1	–	
Costs and prices (%, y/y)							
GDP price deflator	1.4	0.5	-0.3	-0.5	0.0	–	
Consumer Price Index	1.6	1.6	1.0	1.0	1.0	1.0	Jul-98
CPI – excluding food and energy	1.4	1.6	1.1	1.4	1.2	1.3	Jul-98
Unit labour costs	1.3	0.1	-0.7	0.2	0.3		
Wage settlements (total)	0.9	1.6	1.7	1.8	1.6	1.3	Jun-98
Labour market							
Unemployment rate (%)	9.7	9.2	8.9	8.6	8.4	8.3	Aug-98
Employment growth	1.3	1.9	1.8	3.0	2.7	3.1	Aug-98
Financial markets (average)							
Exchange rates (cents U.S.)	73.34	72.24	70.99	69.92	69.13	65.00	Sep-3-98
Prime interest rates (%)	6.06	4.96	5.58	6.33	6.50	7.50	Sep-3-98

[1] Annualized change expressed as a percentage of GDP in the previous period.

Source: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Chart 2
The personal savings rate

Chart 3
Real GDP growth with and without inventories



jump for a third consecutive quarter. With transfers from government falling modestly and personal income taxes rising noticeably, personal disposable income was largely unchanged in the second quarter.

As growth in nominal personal spending exceeded that in nominal disposable income, the personal savings rate fell to -0.7%, its first-ever negative value (Chart 2). This partly reflected measurement issues. The strong gains earned by the personal sector in bond and equity markets up to the second quarter of 1998 represented income to households and likely boosted spending. However such gains are not recorded as income in the national economic and financial accounts since they are not derived from current production. But they do add to the tax liabilities of the personal sector, lowering measured disposable income.

Strong business investment growth resumes

Business investment in plant and equipment jumped 11.5% in the second quarter. Machinery and equipment investment, notably in motor vehicles, soared 14.6% following drops in the previous two quarters. Much of this equipment was imported.

Investment in non-residential buildings and engineering projects, which is satisfied less by imports and so provides a stronger impetus to domestic production, grew sharply again but at only about half the pace of the first quarter. The slowdown was in engineering projects, particularly in the oil and gas industry, as declining oil and gas prices reduced the pace of growth of investment in that area. Investment in building construction, however, continued to grow strongly.

Residential investment, another category with high domestic content, fell 6.4%. There was a sharp 20.6% decline in new construction, largely reflecting the negative impact of labour strikes on housing starts in Ontario, and a modest drop in alterations and improvements. Partly offsetting those declines were soaring transfers costs (primarily real estate commissions), the consequence of sharply rising house resales.

Inventory accumulation sharply lower

Business inventory accumulation dropped from \$10.7 billion in the first quarter to \$6.9 billion in the second, slowing overall growth (Chart 3). This was particularly noticeable for durable goods. Slower growth in overall demand and in inventories left the economy-wide inventory-to-sales ratio up marginally but still near its all-time low and well below levels in the early 1990s.

Import growth exceeds export growth

Strong foreign demand for Canadian products boosted real exports 5.3% in the second quarter, modestly off the pace in the previous quarter, despite continuing problems in Asia. Stronger domestic demand growth, and the shift in that demand toward consumer durables and business machinery and equipment, boosted imports. As a result, real imports rose 6.1% and the real trade balance fell modestly.

Current account deficit largely unchanged

The current account deficit fell marginally to $16.9 billion or 1.9% of nominal GDP. This reflected an improvement in the investment income deficit that offset the deterioration in the trade balance.

Inflation subdued while profits slump

With the economy operating below potential, underlying price and cost pressures remained subdued in the quarter.

The implicit price index for GDP, despite rising 1.1% in the second quarter, was unchanged from its level a year earlier because of previous declines. Prices have remained at year-ago levels because weakening export prices, a reflection of softening world commodity prices, have offset gains in sectors such as services.

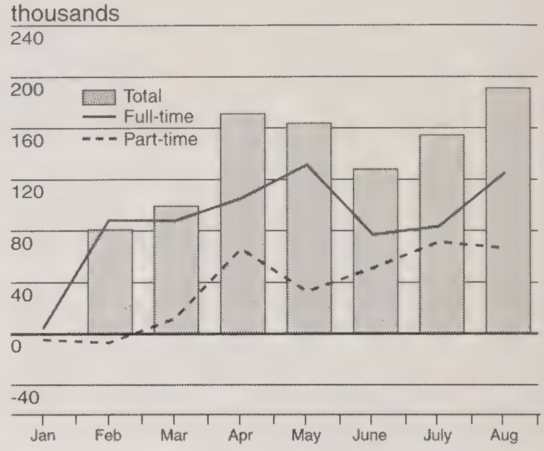
Labour costs per unit of output rose 0.7% relative to their first quarter level, reflecting a decline in labour productivity. But unit labour costs were up only 0.3% from their level of a year earlier.

Pre-tax corporate profits slumped a further 9.1% in the second quarter, to an 8.5% share of nominal GDP. This followed a very sharp 29.3% contraction in the first quarter and reflected the impact on profits of falling commodity prices and slowing economic activity.

Job creation resumed

Employment jumped by 171,000 during the first four months of 1998 before easing back somewhat in May and June. Job creation resumed in July and August despite the negative impact of the strike against General Motors in the United States (Chart 4). The unemployment rate was down slightly to 8.3% in August, the lowest rate since mid-1990.

Chart 4
Cumulative employment growth during 1998



The Canadian dollar weakens and interest rates move higher

The Canadian dollar closed at an all-time low of 63.31 cents U.S. on August 27. The dollar has been adversely affected by the Asian and then Russian crises, the fall-out on commodity prices and a market preference for assets denominated in U.S. dollars.

The Canadian dollar has since recovered somewhat to trade above 65 cents U.S. following the 1-percentage-point hike in the Bank Rate on August 27.

Short-term interest rates stand more than 2½ percentage points higher than their lowest levels during 1997. Long rates continued to fall until into July before rising modestly, but they remain slightly below their levels at the end of 1997.

With the rise in Canadian interest rates and falls in corresponding U.S. rates, Canadian rates are above U.S. rates across the maturity spectrum for the first time since March 1996.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE — MARCH 1999

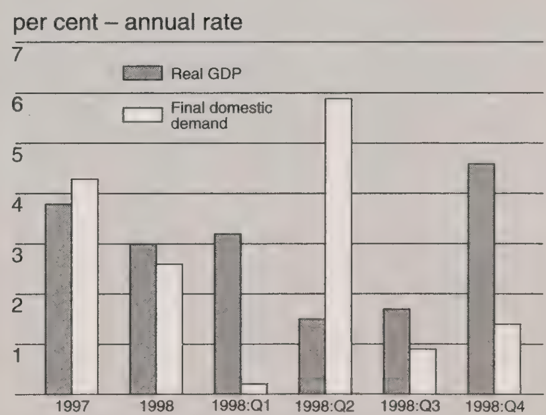
KEY MESSAGES

- In the fourth quarter of 1998, real GDP growth increased sharply to 4.6% from its more moderate average pace of 1.6% in the previous two quarters. The growth rate for all of 1998 was 3.0%.
- Stronger foreign demand, especially for automotive products in the United States, contributed to a 16.2% increase in real exports in the fourth quarter, boosting Canadian production.
- A large positive swing in business inventory investment from the third to the fourth quarter also contributed to the increase in growth. The inventory accumulation was largely in motor vehicles and was accomplished through both domestic production and increased imports. Excluding inventories, real GDP rose 1.3% in the fourth quarter.
- Growth in demand by Canadians for consumer goods and services, housing and non-residential construction remained modest while investment in machinery and equipment continued to grow strongly.
- Part of the increase in total demand was met through sharply higher imports, especially of automotive products, computers and other office equipment.
- Real personal disposable income jumped 2.4% in the fourth quarter, bringing its increase for 1998 as a whole to 1.9%, its first significant annual increase since 1995.
- The robust employment growth seen since June of last year continued into 1999. With a total gain of 100,000 in January and February, cumulative job creation climbed to over 550,000 since the end of 1997. The unemployment rate in February was 7.8%, its lowest level in over eight years.

SUMMARY[1]

In the fourth quarter of 1998, Canadian exports continued to be a major force behind growth in real GDP. A large swing in inventory investment also boosted Canadian production. But final domestic demand gains remained modest, with import growth accounting for an increased share of total demand (Chart 1). Domestic cost and inflation pressures remained subdued.

Chart 1
Growth in real GDP and real final domestic demand



1 Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, March 12, 1999.

Strong export growth boosts production

Strong foreign demand for Canadian products boosted real exports 16.2% in the fourth quarter, double the pace of the previous quarter. The increase in exports was concentrated in automotive products to the United States. Strong economic growth in that country, increased Canadian competitiveness and a rebound from the effects on Canadian production of a strike at General Motors in the United States in the summer of 1998 were the major factors behind this strengthening of Canadian exports.

Consumers limit spending gains

Real consumer expenditure growth eased further to 0.8% in the fourth quarter from 1.5% in the third and 6.0% in the second. Spending on goods, particularly on motor vehicles, fell while spending on services rose moderately.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1997	1998	1998:Q2	1998:Q3	1998:Q4	Most recent	
Real gross domestic product	3.8	3.0	1.5	1.7	4.6	–	
GDP excluding inventories	3.0	3.4	3.0	7.0	1.3	–	
Final domestic demand	4.3	2.6	5.9	0.9	1.4	–	
Government expenditure	-1.5	1.0	2.8	1.3	1.1	–	
Consumer expenditure	4.1	2.7	6.0	1.5	0.8	–	
Residential investment	12.4	-1.6	-3.7	-9.8	2.4	–	
Business fixed investment	15.0	6.7	15.7	1.8	4.6	–	
Non-residential construction	8.4	1.9	2.7	-0.9	-1.0	–	
Machinery and equipment	19.6	9.8	24.4	3.4	8.0	–	
Business inventory change[1]	0.8	-0.4	-1.4	-4.9	3.3	–	
Trade balance[1]	-1.5	0.7	-2.6	5.6	0.6	–	
Exports	8.0	8.1	2.2	7.7	16.2	–	
Imports	13.3	6.4	9.8	-7.0	15.5	–	
Current account balance							
(nominal $ billion)	-12.8	-18.4	-20.2	-18.3	-20.9	–	
(percentage of GDP)	-1.5	-2.1	-2.3	-2.1	-2.3	–	
Real personal disposable income	0.2	1.9	0.0	-0.7	2.4	–	
Profits before taxes	13.3	-5.3	-4.3	-4.1	11.9	–	
Costs and prices (%, y/y)							
GDP price deflator	0.7	-0.5	0.0	-0.7	-0.6	–	
Consumer Price Index	1.6	0.9	1.0	0.9	1.1	0.6	Jan-99
CPI – excluding food and energy	1.6	1.3	1.2	1.4	1.5	1.0	Jan-99
Unit labour costs	0.9	0.8	1.0	0.9	0.8	1.3	Dec-98
Wage settlements (total)	1.6	1.7	1.7	1.4	1.7	2.2	Dec-98
Labour market							
Unemployment rate (%)	9.2	8.3	8.4	8.3	8.0	7.8	Feb-99
Employment growth	1.9	2.8	2.6	1.9	5.1	1.1	Feb-99
Financial markets (average)							
Exchange rates (¢ U.S.)	72.24	67.48	69.13	66.03	64.84	65.55	Mar-11-99
Prime interest rates (%)	4.96	6.60	6.50	6.75	6.83	6.75	Mar-11-99

1 Annualized change expressed as a percentage of GDP in the previous period.

Source: Statistics Canada, Bank of Canada and Human Resources Development Canada.

Personal income grew 3.8% in the fourth quarter, nearly double its pace of the previous quarter, with labour income rising much more sharply than in the third quarter. More jobs were created in the fourth quarter than in any quarter on record (dating back to 1976), and full-time jobs rose sharply. Also, part of the income acceleration reflected the end of labour disputes in Canada and the United States, which had depressed earnings in the middle of 1998.

With personal taxes rising at about the same pace as in the previous quarter, real personal disposable income increased 2.4% following a drop in the third quarter. For 1998 as a whole, real personal disposable income increased 1.9%, the first significant annual gain since 1995.

As growth in nominal disposable income exceeded growth in nominal personal spending, the personal savings rate rose to 0.8% from 0.4% in the third quarter.

Stronger growth in business investment

Business investment in plant and equipment rose 4.6% in the fourth quarter, a stronger pace than in the previous quarter. The acceleration came in import-intensive machinery and equipment investment, with growth in that category rising to 8.0% from 3.4% in the third quarter. Investment in non-residential construction fell 1.0%, a second consecutive decline. The slowdown resulted from another drop in engineering projects, notably in the oil and gas industry, while building construction continued to rise.

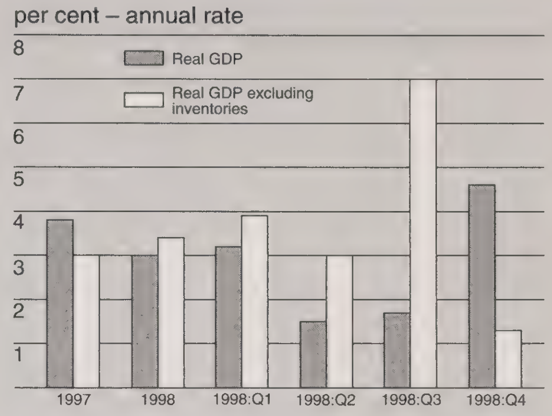
Residential investment rose 2.4% following a drop in the third quarter. Increased housing starts boosted new house construction activity, and spending on alterations and improvements also rose. This was partly offset by sharply lower real estate commissions, the result of fewer house resales in the quarter.

Inventories add to production

Businesses increased their non-farm inventories by $3.6 billion in the fourth quarter following a decumulation of $2.6 billion in the third quarter. Even with the relatively high import content of inventory investment, this accumulation had a significant positive impact on production (Chart 2). Most of the inventory build-up came in motor vehicles and in the retail and wholesale sectors. The summer strike at General Motors in the United States had previously pared stocks.

With strong exports boosting sales, the economy-wide inventory-to-sales ratio declined, remaining well below the levels of the early 1990s.

Chart 2
Real GDP growth with and without inventories



Imports rebound strongly

Real imports rose sharply in the fourth quarter owing to the stronger Canadian demand for import-intensive machinery and equipment and automotive products.

Current account deficit increases

The import rebound was more than offset by stronger real export growth, so the real trade surplus rose modestly in the fourth quarter. However, the nominal trade surplus fell slightly as import prices rose more than export prices in the quarter. That development, plus a widening of the investment income deficit, caused the fourth-quarter current account deficit to increase by $2.6 billion from the third quarter; in the fourth quarter the current account deficit reached $20.9 billion, or 2.3% of nominal GDP. The deterioration in the investment income account resulted from increased retained earnings assigned to non-residents from profits earned in Canada.

For 1998 as a whole, the current account deficit worsened by $5.6 billion from 1997, increasing to $18.4 billion, or 2.1% of nominal GDP.

Inflation subdued while profits climb

With the economy operating at a level of production below potential, underlying price and cost pressures remained subdued in the fourth quarter. Both the implicit price index and the chain price index were below their levels of a year earlier, owing in part to lower export prices than at the end of 1997. Weak commodity prices help to explain this development.

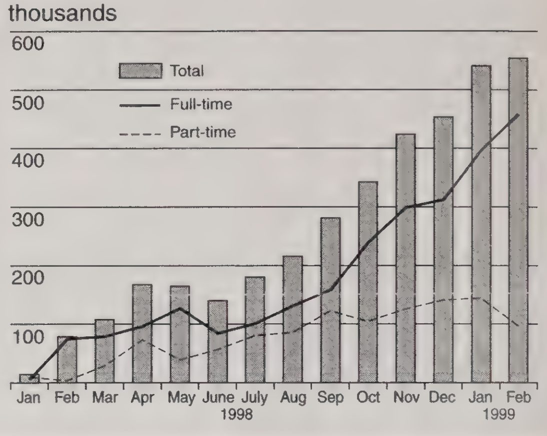
Labour costs per unit of output fell marginally from their third-quarter level and were up only 0.8% from their level of a year earlier. Both the average wage and labour productivity fell slightly in the fourth quarter.

Pre-tax corporate profits climbed 11.9% after having fallen 4.1% in the third quarter. Gains in the quarter were most notable in the motor vehicle industry, as the General Motors strike in the United States in the summer had negatively impacted profits in Canada in the third quarter. This overall rise in profits followed contractions in the first three quarters of the year, and their level in the fourth quarter remained 8.4% below that of a year-earlier.

Robust job creation continues

Fourth-quarter employment growth was 5.1%, its strongest rate of growth since the last quarter of 1987. The growth rate of 2.8% in 1998 as a whole reflected the over 450,000 net new jobs added during the year. Robust job creation continued into 1999, with another 100,000 net new positions created in January and February together (Chart 3). The unemployment rate declined from 8.1% in September to 7.8% in January and February, its lowest level in over eight years. Further, the job gains since September were largely in full-time employment.

Chart 3
Cumulative employment growth since December 1997



The Canadian dollar strengthens

After having traded around 65 cents U.S. for most of the last four months of 1998, the Canadian dollar strengthened somewhat in January and February, peaking at over 67 cents U.S. in mid-February. However, more recently, the dollar has weakened in response to renewed concerns about the global commodity price outlook and the continued strength of the U.S. economy. On March 11, the dollar closed at 65.55 cents U.S.

The Canadian dollar has strengthened somewhat against the Euro, the new common currency of the European Monetary Union, since it was launched at the start of 1999.

Although relatively stable during December and January, short- and long-term interest rates have risen since mid-February. This reflects some spillover into Canada of upward pressure on market interest rates in the United States coming from the continuing strong performance of that economy. This pressure, however, eased after the United States released favourable wage growth and productivity reports in early March.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Steven James at (613) 992-4321.
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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JULY 1999

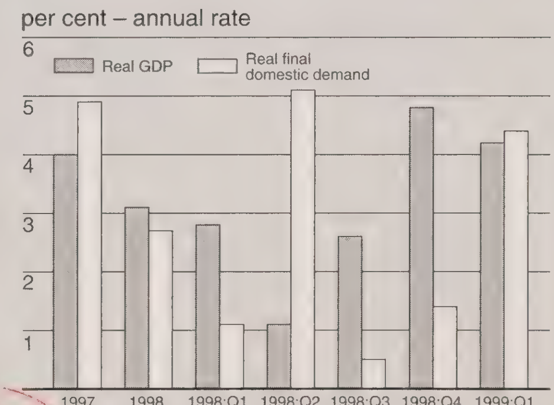
KEY MESSAGES

- In the first quarter of 1999, real gross domestic product (GDP) grew a solid 4.2% following a robust 4.8% gain in the fourth quarter of 1998.
- Unlike the previous quarter when demand growth was more narrowly concentrated, the strength in the first quarter was widespread. Growth in demand by Canadians for consumer goods and services, housing and business investment rose sharply. This increased demand led to imports rising at a similar pace.
- Stronger foreign demand also contributed to growth through an 8.5% increase in real exports in the quarter, boosting Canadian production.
- A smaller accumulation in business inventories than in the fourth quarter of last year limited the first quarter growth rate. Excluding inventories, real GDP rose 5.4%, up from 1.3% in the previous quarter.
- With stronger export growth than import growth, the increase in the trade surplus resulted in an impressive reduction in the current account deficit from $16.5 billion to $5.4 billion.
- Despite a modest loss on balance since February, the employment gain from the end of 1998 to May exceeded 73,000, with the gain entirely in full-time jobs. This brought the number of net new jobs created since June 1998 to nearly 400,000. The unemployment rate in May was 8.1%, down from 8.3% in April but slightly above the 7.8% seen during the first three months of 1999.

SUMMARY[1]

In the first quarter of 1999, the strength in demand was widespread. Final domestic demand (spending by consumers, business and government on goods, services, housing and plant and equipment) and foreign demand boosted Canadian production (Chart 1). A negative swing in inventory investment, however, moderated overall growth so that it was somewhat slower than in the fourth quarter. Domestic cost and inflation pressures remained subdued.

Chart 1
Growth in real GDP and real final domestic demand



[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of the day, July 5, 1999.

Consumers return to the stores

Real consumer expenditure increased 5.1% in the first quarter following a very weak performance in the fourth quarter of 1998. Spending on goods, particularly on durables such as motor vehicles, furniture and appliances, rose sharply.

Personal income grew 2.7% in the first quarter, a more modest advance than in the previous quarter, as the pace of increase for most major forms of income eased. Labour income growth slowed in conjunction with a less robust gain in employment than in the fourth quarter.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1997	1998	1998:Q3	1998:Q4	1999:Q1	Most recent	
Real gross domestic product	4.0	3.1	2.6	4.8	4.2	–	
GDP excluding inventories	3.2	3.6	7.4	1.3	5.4	–	
Final domestic demand	4.9	2.7	0.5	1.4	4.4	–	
Government expenditure	-1.0	2.0	1.0	2.2	-0.3	–	
Consumer expenditure	4.2	2.8	0.9	0.0	5.1	–	
Residential investment	12.6	-1.9	-9.4	0.3	16.6	–	
Business fixed investment	18.8	5.7	2.1	6.8	5.2	–	
Non-residential construction	14.0	0.1	-3.8	-2.4	-1.1	–	
Machinery and equipment	22.2	9.5	5.9	12.7	8.9	–	
Business inventory change[1]	0.7	-0.4	-4.5	3.4	-1.1	–	
Trade balance[1]	-1.7	1.0	6.6	-0.2	1.8	–	
Exports	8.5	8.2	11.2	14.2	8.5	–	
Imports	14.6	5.8	-6.2	15.9	4.2	–	
Current account balance							
(nominal $ billion)	-14.3	-16.4	-15.3	-16.5	-5.4	–	
(percentage of GDP)	-1.6	-1.8	-1.7	-1.8	-0.6	–	
Real personal disposable income	1.3	2.4	-0.6	2.7	1.7	–	
Profits before taxes	8.5	-6.0	3.5	13.0	25.6	–	
Costs and prices (%, y/y)							
GDP price deflator	0.8	-0.6	-0.7	-0.7	0.0	–	
Consumer Price Index	1.6	0.9	0.9	1.1	0.8	1.7	99-Apr
CPI – excluding food and energy	1.6	1.3	1.4	1.5	1.0	1.4	99-Apr
Unit labour costs	1.8	0.9	0.6	0.7	-0.5		
Wage settlements (total)	1.4	1.7	1.4	1.7	1.5	1.4	99-Mar
Labour market							
Unemployment rate (%)	9.2	8.3	8.3	8.0	7.8	8.1	99-May
Employment growth	1.9	2.8	1.9	5.1	3.7	-1.1	99-May
Financial markets (average)							
Exchange rates (¢ U.S.)	72.24	67.48	66.03	64.84	66.17	68.11	5-Jul-99
Prime interest rates (%)	4.96	6.60	6.75	6.83	6.75	6.25	5-Jul-99

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

With personal taxes rising faster than in the previous quarter and faster than personal income, real personal disposable income growth moderated to 1.7%.

As growth in nominal disposable income fell short of that in nominal personal spending, the personal savings rate fell to 1.4% from 2.2% in the fourth quarter.

Investment remains vibrant

Real business investment in plant and equipment climbed a solid 5.2% in the first quarter, a slower pace than in the previous quarter, however. Growth in machinery and equipment investment was again very strong, with computers and other office equipment contributing a significant share of the gain. Part of this may have been a response to tax incentives for small and medium-sized businesses to update hardware to be year 2000 compliant. Investment in non-residential construction declined somewhat. Both engineering projects and building construction contributed to this weakening.

Real residential investment jumped 16.6% following almost no change in the previous quarter. Increased housing starts boosted new house construction activity in the quarter while increased house resales boosted real estate commissions. Alterations and improvements also rose sharply.

Strong export growth boosts production

Strong foreign demand for Canadian products continued to boost real exports in the first quarter. However, real exports grew at a slower pace than in the fourth quarter, when automotive exports soared to replenish stocks depleted by the strike at General Motors in the United States in the summer of 1998. The increase in exports in the first quarter was concentrated in trade with the United States. Strong economic growth in that country and greater overall Canadian competitiveness have been the major factors behind rising Canadian exports.

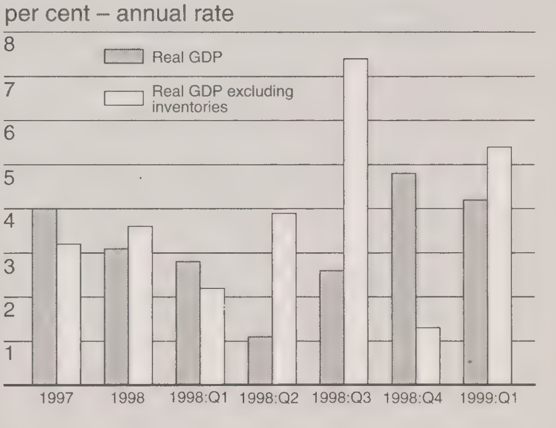
Imports grow with domestic demand

In the first quarter, real imports rose at about the same pace as final domestic demand. The gain was highly correlated with the need to satisfy stronger Canadian demand for import-intensive machinery and equipment.

Inventory accumulation slows

Businesses increased their non-farm inventories by $0.7 billion in the first quarter following a much larger accumulation of $3.1 billion in the fourth quarter. Retail and wholesale inventories of motor vehicles declined after having surged in the previous quarter. With less output required for restocking, production growth slowed despite the surge in demand (Chart 2).

Chart 2
Real GDP growth with and without inventories



With strong domestic and foreign demand boosting sales, the economy-wide inventory-to-sales ratio declined and is again approaching its lowest recorded level.

Current account deficit improves

Stronger real export than import growth sharply boosted the real trade surplus. This was reinforced by a gain in the terms of trade (export prices declined less than import prices),

and together these factors nearly doubled the nominal trade surplus relative to its fourth quarter level. When combined with a modest deterioration in the investment income deficit due to lower receipts from profits on Canadian direct investment abroad, the current account deficit sharply improved from $16.5 billion to $5.4 billion, or 0.6% of nominal GDP – its lowest level in two years.

Inflation subdued while profits soar

With the economy operating at a level of production below potential, underlying price and cost pressures remained subdued in the first quarter. The implicit price index was unchanged from its year-earlier level while the chain price index was up only 0.3%. The 12-month rate of increase for consumer prices rose to 1.7% in April, owing in part to the temporary impact of higher energy prices.

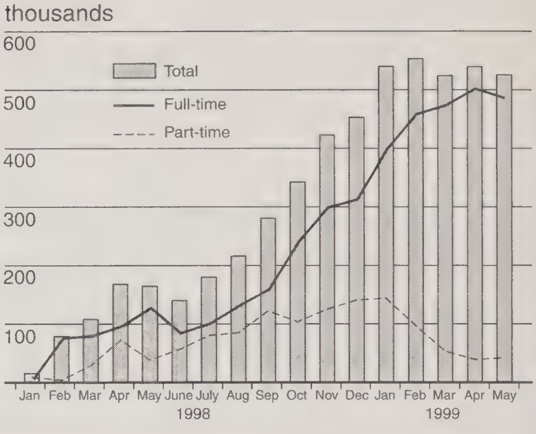
Labour productivity, when measured as output per employed person, rose somewhat in the first quarter. Labour costs per unit of output fell from their fourth quarter level and were 0.5% below that of a year earlier.

Pre-tax corporate profits surged 25.6% after having risen 13.0% in the fourth quarter. These gains raised profits to 8.3% above their level of a year earlier and almost restored the previous losses that occurred after the peak in profits in the fourth quarter of 1997. Gains in the quarter were most notable in non-financial industries such as motor vehicle and other transportation industries, primary industries (given some rebound in commodity prices in the quarter), general services to business, and consumer goods and services.

Job creation has been impressive

First quarter employment increased 3.7%, slower than the 5.1% pace of the fourth quarter when it was at its strongest since the last quarter of 1987. Employment gains, however, have paused in recent months, with a small net loss since February (Chart 3).

Chart 3
Cumulative employment growth since December 1997



The unemployment rate was 8.1% in May, down from 8.3% in April but up from 7.8% in the three previous months.

Canadian dollar strengthens

After having traded around 65 cents U.S. for most of the last four months of 1998, the Canadian dollar has strengthened in 1999 in line with firming world commodity prices, peaking near 69 cents U.S. in early May. On July 5, the dollar closed at 68.11 cents U.S.

After having risen from December to early March due to upward pressure on market interest rates in the United States coming from the continuing strong performance of that economy, short- and long-term Canadian interest rates then eased back until early May. The Bank of Canada reduced its official Bank Rate in late March and again in early May. Market interest rates increased modestly again after an unfavourable inflation report in the United States raised expectations of a policy tightening by the Federal Reserve. This proved to be correct as the Federal Funds Rate was raised by 25 basis points on June 30. Market interest rates in Canada were thus largely unaffected.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 1999

KEY MESSAGES

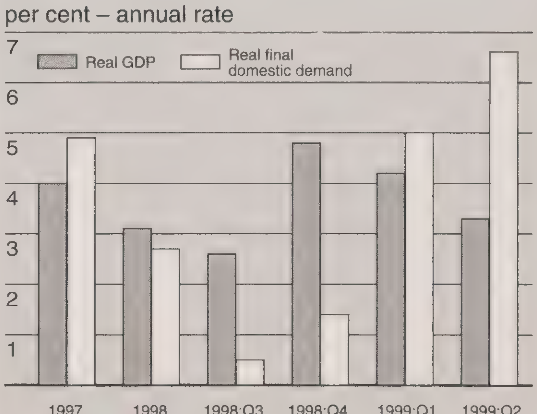
- In the second quarter of 1999, real gross domestic product (GDP) grew a solid 3.3% following gains of over 4% in the previous two quarters.
- Demand growth in the quarter was relatively widespread. Private and public demand for goods and services, housing and investment rose 6.6% in the quarter, stronger than the 5.0% pace recorded in the first quarter. Inventory accumulation also boosted output in the second quarter.
- Stronger foreign demand contributed to increased Canadian production through a 1.5% increase in real exports, although this was a much smaller gain than in recent quarters. But rising imports satisfied much of the increased domestic demand, moderating the gain in real GDP. As a result of these movements, real economic growth slowed moderately and the real trade balance worsened.
- The decrease in the nominal trade surplus, however, was modest as the decline in the real trade balance was largely offset by a gain in the terms of trade (export prices rose while import prices fell). The current account deficit worsened slightly from $4.0 billion to about $5.3 billion but was still much better than the levels observed throughout 1998.
- July employment stood nearly 116,000 above the level at the end of 1998, with full-time jobs accounting for more than the total net gain. Nearly 400,000 net new jobs were created between July 1998 and July 1999. The unemployment rate in July was 7.7%, down from 8.3% in April, but slightly above the 7.6% seen in June.

SUMMARY[1]

In the second quarter of 1999, the impetus to growth came largely from increased domestic demand. Final domestic demand (spending by consumers, business and government on goods, services, housing and plant and equipment) rose at its fastest rate in nearly three years (Chart 1) and, along with a large positive swing in inventory investment, boosted production. But weaker export growth than in the first quarter and rising imports to meet the increased domestic demand slowed the pace of growth slightly relative to that in the first quarter. Cost and inflation pressures remained relatively subdued.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is August 31, 1999.

Chart 1
Growth in real GDP and real final domestic demand



Consumers still spending

Real consumer expenditure increased 3.0% in the second quarter following a 4.2% gain in the first quarter of 1999. Growth in spending on services was nearly double its pace in the first quarter while that on goods was noticeably slower, with an outright decline in spending on automotive products.

Personal income grew 3.4% in the second quarter, about the same pace as in the first quarter. Labour income growth was sustained by a pickup in the average wage per employed person.

With personal taxes rising faster than in the previous quarter, and faster than personal income, real personal disposable income growth moderated to 0.8%.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1997	1998	1998:Q4	1999:Q1	1999:Q2	Most recent	
Real gross domestic product	4.0	3.1	4.8	4.2	3.3	-	
GDP excluding inventories	3.2	3.6	1.3	6.0	0.2	-	
Final domestic demand	4.9	2.7	1.4	5.0	6.6	-	
Government expenditure	-1.0	2.0	2.2	1.4	4.2	-	
Consumer expenditure	4.2	2.8	0.0	4.2	3.0	-	
Residential investment	12.6	-1.9	0.3	18.6	15.4	-	
Business fixed investment	18.8	5.7	6.8	9.6	25.3	-	
Non-residential construction	14.0	0.1	-2.4	4.5	1.5	-	
Machinery and equipment	22.2	9.5	12.7	12.7	40.5	-	
Business inventory change[1]	0.7	-0.4	3.4	-1.7	3.1	-	
Trade balance[1]	-1.7	1.0	-0.2	2.0	-5.5	-	
Exports	8.5	8.2	14.2	9.5	1.5	-	
Imports	14.6	5.8	15.9	4.5	18.2	-	
Current account balance							
(nominal $ billion)	-14.3	-16.4	-16.5	-4.0	-5.3	-	
(percentage of GDP)	-1.6	-1.8	-1.8	-0.4	-0.6	-	
Real personal disposable income	1.3	2.4	2.7	3.1	0.8	-	
Profits before taxes	8.5	-6.0	13.0	29.5	16.5	-	
Costs and prices (%, y/y)							
GDP price deflator	0.8	-0.6	-0.7	0.4	1.0	-	
Consumer price index	1.6	0.9	1.1	0.8	1.6	1.8	99-Jul
CPI – excluding food and energy	1.6	1.3	1.5	1.0	1.5	1.7	99-Jul
Unit labour costs	1.8	0.9	0.7	-0.3	-0.6		
Wage settlements (total)	1.4	1.7	1.7	1.5	2.4	2.5	99-Jun
Labour market							
Unemployment rate (%)	9.2	8.3	8.0	7.8	8.0	7.7	99-Jul
Employment growth	1.9	2.8	5.1	3.7	-0.2	3.3	99-Jul
Financial markets (average)							
Exchange rates (cents U.S.)	72.24	67.48	64.84	66.17	67.90	67.00	31-Aug-99
Prime interest rate (%)	4.96	6.60	6.83	6.75	6.33	6.25	31-Aug-99

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

As growth in nominal disposable income fell short of that in nominal personal spending, the personal savings rate fell to 1.4% from 1.9% in the first quarter.

Investment activity soars

Business investment in plant and equipment soared 25.3% in the second quarter, more than double the pace in the first quarter. Growth in machinery and equipment investment exceeded 40%. Computer purchases contributed significantly to the gain, at least partly due to continued efforts to improve Y2K readiness. Investment in non-residential construction recorded a smaller gain than in the first quarter, as building construction rose while engineering construction fell, largely due to reduced oil and gas drilling activity.

Residential investment jumped 15.4%, only somewhat off the 18.6% pace of the first quarter. Much higher house resales sharply boosted real estate commissions. An increase in housing starts raised new house construction activity while renovations also registered a healthy increase.

Exports rise but imports surge

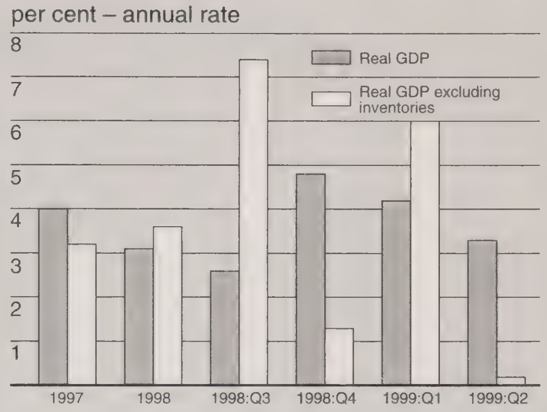
Foreign demand for Canadian products contributed to higher real exports in the second quarter, which, however, rose at a much slower pace than in recent quarters. Slower growth in final domestic demand and lower inventory accumulation in the United States reduced the pace of import growth from Canada. In contrast, total real imports by Canadians rose a strong 18.2% in the second quarter, driven by business investment as large gains in imports of machinery and equipment were recorded.

Inventory accumulation climbs

Businesses increased their inventories by $6.8 billion in the second quarter following a much smaller accumulation of $0.2 billion in the first quarter. This buildup, combined with strong final domestic demand, was a factor behind the growth in production (Chart 2).

With strong domestic demand boosting sales and the sharp accumulation in inventories, the economy-wide inventory-to-sales ratio fell slightly, remaining near its lowest recorded level.

Chart 2
Real GDP growth with and without inventories



Current account deficit roughly stable

The decline in the trade surplus relative to the first quarter, due to stronger real import than export growth, was largely moderated by a gain in the terms of trade. There were noticeable increases in commodity prices, which supported higher export prices. Energy prices rose significantly, for example, as OPEC restricted its supply of crude petroleum.

The modest reduction in the nominal trade surplus, combined with a deterioration in net transfers and a slight improvement in the investment income deficit, produced a slight worsening of the current account deficit from $4.0 billion to about $5.3 billion, or 0.6% of nominal GDP. But this was still much better than the levels observed throughout 1998.

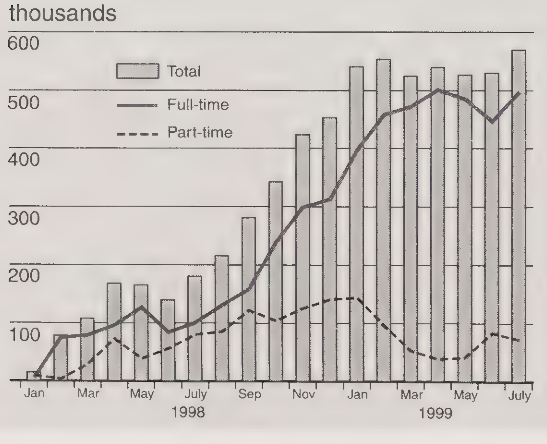
Inflation subdued while profits jump

With the economy still operating below potential, underlying price and cost pressures remained subdued in the second quarter. The implicit and chain price indices for GDP were both only 1.0% above their year-earlier levels despite noticeable jumps in the second quarter. Consumer prices accelerated to 1.8% in July on a year-over-year basis, owing in part to the temporary impact of higher energy prices.

Labour productivity, when measured as output per employed person, rose noticeably in the second quarter. And labour costs per unit of output rose modestly from their first quarter level but remained 0.6% below that of a year earlier.

Pre-tax corporate profits surged another 16.5% after having risen 13.0% and 29.5% in the fourth quarter of 1998 and the first quarter of 1999 respectively. These gains raised profits to 9.8% of nominal GDP and to a level 15.3% above that of a year earlier.

Chart 3
Cumulative employment growth since December 1997



Job creation resumes

Second quarter employment fell slightly after increasing 5.1% in the fourth quarter of 1998 and 3.7% in the first quarter of 1999. But employment growth has resumed, with the addition of 40,000 net new jobs in July (Chart 3). The unemployment rate was 7.7% in July, up from 7.6% in June but down from 8.3% in April. These are the lowest rates of unemployment in Canada in the last nine years.

The Canadian dollar gives back some gains

After having traded around 65 cents U.S. in the last quarter of 1998, the Canadian dollar strengthened along with world commodity prices, peaking near 69 cents U.S. in early May 1999. It has since lost some ground, trading near 67 cents U.S. On August 31, the dollar closed at 67 cents U.S.

After easing back from March until early May, Canadian market interest rates rose along with those in the United States.

The U.S. Federal Reserve raised the target for the Federal Funds Rate from 5% to 5.25% on August 24, its second round of monetary tightening in 1999. These moves were aimed at staving off inflationary pressures given a tight U.S. labour market, continued strong U.S. domestic demand and firming foreign economies.

The Bank of Canada did not match the August increase by the Federal Reserve and as a result interest rates in Canada generally remained below those in the United States.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE DECEMBER 1999

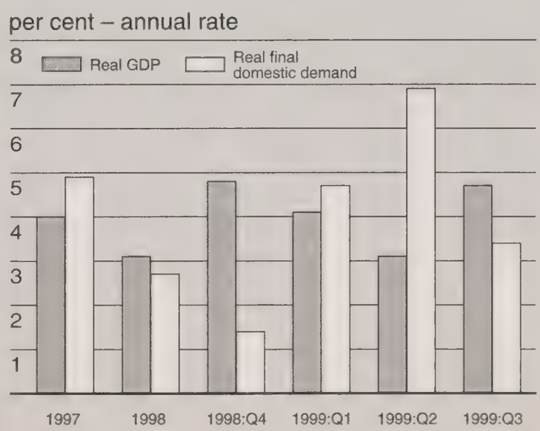
KEY MESSAGES

- In the third quarter of 1999, real gross domestic product (GDP) grew sharply, rising 4.7% following a gain of 3.1% in the second quarter. This brought output to 4.2% above its level a year earlier.
- Demand growth in the quarter was balanced. Much stronger foreign demand boosted real exports by 15.0%, contributing to increased Canadian production. Private and public domestic demand for goods and services, housing and investment also continued to grow, although at a slower pace than in the second quarter.
- While rising imports did satisfy part of the increased demand, the nominal trade surplus rose significantly despite a modest decline in the terms of trade (export prices rose less than import prices). The current account improved sharply, going from a deficit of about $7 billion in the second quarter to a surplus of about $2.6 billion in the third quarter, its best level and first surplus since 1996. As a share of nominal GDP, the current account surplus was 0.3%, significantly better than the average deficit of 1.8% in 1998.
- Canadian labour productivity (output per employed person) registered an impressive gain of 3.2% in the third quarter, as employment rose 1.5%.
- With a further gain of about 60,000 jobs in the month, November employment stood at over 310,000 above the level at the end of 1998, with full-time jobs accounting for more than the total net gain. More than 340,000 net new jobs were created in the 12 months since November 1998. The unemployment rate in November 1999 was 6.9%, the lowest rate since August 1981.

SUMMARY[1]

In the third quarter of 1999, the Canadian economy continued its solid performance. The sharp gain in output in the quarter came from both increased foreign and domestic demand. Very strong export growth boosted the growth rate of Canadian production above that of the previous quarter. Final domestic demand (spending by Canadian consumers, business and government on goods, services, housing and plant and equipment) also continued to rise (Chart 1). Meanwhile, cost and inflation pressures remained relatively subdued.

Chart 1
Growth in real GDP and real final domestic demand



[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is December 3, 1999.

Department of Finance Canada Ministère des Finances Canada

Canada

Consumers continue to buy

Real consumer expenditure increased 4.8% in the third quarter following gains of over 4% in the previous two quarters. Spending rose much more sharply than in the second quarter on all major categories of durables. Purchases of automotive products rebounded strongly from a decline in the second quarter. Growth in services remained significant but was only about half the pace in the previous quarter.

Personal income grew 3.8% in the third quarter, a slightly faster pace than in the second quarter. Labour income, which also registered a growth rate similar to that in the previous quarter, increased as a result of gains in both employment and the average wage per worker.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1997	1998	1999:Q1	1999:Q2	1999:Q3	Most recent	
Real gross domestic product	4.0	3.1	4.1	3.1	4.7	-	
GDP excluding inventories	3.2	3.6	5.8	-0.3	7.1	-	
Final domestic demand	4.9	2.7	4.7	6.9	3.4	-	
Government expenditure	-1.0	2.0	0.1	3.0	1.1	-	
Consumer expenditure	4.2	2.8	4.4	4.3	4.8	-	
Residential investment	12.6	-1.9	17.3	14.0	2.5	-	
Business fixed investment	18.8	5.7	9.8	23.9	1.7	-	
Non-residential construction	14.0	0.1	8.0	3.2	8.5	-	
Machinery and equipment	22.2	9.5	10.9	37.0	-1.8	-	
Business inventory change[1]	0.7	-0.4	-1.6	3.4	-2.2	-	
Trade balance[1]	-1.7	1.0	1.7	-5.8	3.7	-	
Exports	8.5	8.2	10.1	1.4	15.0	-	
Imports	14.6	5.8	6.1	18.8	5.5	-	
Current account balance							
(nominal $ billion)	-14.3	-16.4	-6.1	-7.0	2.6	-	
(percentage of GDP)	-1.6	-1.8	-0.7	-0.7	0.3	-	
Real personal disposable income	1.3	2.4	2.0	1.5	2.5	-	
Profits before taxes	8.5	-6.0	25.6	18.4	49.6	-	
Costs and Prices (%, y/y)							
GDP price deflator	0.8	-0.6	0.3	0.8	2.3	-	
Consumer price index	1.6	0.9	0.8	1.6	2.2	2.3	99-Oct
CPI - excluding food and energy	1.6	1.3	1.0	1.5	1.6	1.6	99-Oct
Unit labour costs	1.8	0.9	-0.2	-0.4	0.3		
Wage settlements (total)	1.4	1.7	1.5	2.4	2.3	3.0	99-Sep
Labour market							
Unemployment rate (%)	9.2	8.3	7.8	8.0	7.6	6.9	99-Nov
Employment growth	1.9	2.8	3.7	-0.2	1.5	5.0	99-Nov
Financial markets (average)							
Exchange rates (cents U.S.)	72.24	67.48	66.17	67.90	67.30	67.49	2-Dec-99
Prime interest rate (%)	4.96	6.60	6.75	6.33	6.25	6.50	2-Dec-99

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

With personal taxes rising at a slower pace than in the previous quarter, and slower than personal income, real personal disposable income growth jumped to 2.5%. But with strong growth in nominal personal spending outpacing that in nominal disposable income, the personal savings rate fell to 0.3% from 0.9% in the second quarter.

Investment activity rises more moderately

Business investment in plant and equipment increased 1.7% in the third quarter, a much slower pace than in the previous quarter. Investment in non-residential construction grew noticeably more than in the second quarter, with similar gains in both building and engineering structures. However, machinery and equipment investment actually slipped slightly after rising 37.0% in the previous quarter. The sharp slowdown was due to fewer aircraft purchases and a levelling off in computer investment, perhaps the result of firms having already largely dealt with potential Y2K problems.

Residential investment growth also slowed from its pace in the previous two quarters. While total housing starts were similar in the second and third quarters, a shift from multiple units to single homes, which create more activity per average unit, boosted new construction activity in the third quarter. Transfer costs also registered a smaller gain than in the second quarter, but renovations declined, largely offsetting the gains in the other two components.

Exports surge

Much stronger foreign demand for Canadian products contributed to a sharp jump of 15.0% in real exports in the third quarter. One factor behind this was strong growth in real GDP in the United States in the third quarter. This boosted U.S. imports from Canada, especially of automotive products. Canadian exports of computers and telecommunications equipment also rose sharply. In contrast, total real imports by Canadians rose a more modest 5.5% in the third quarter, reflecting slowdowns in business investment and imports of machinery and equipment.

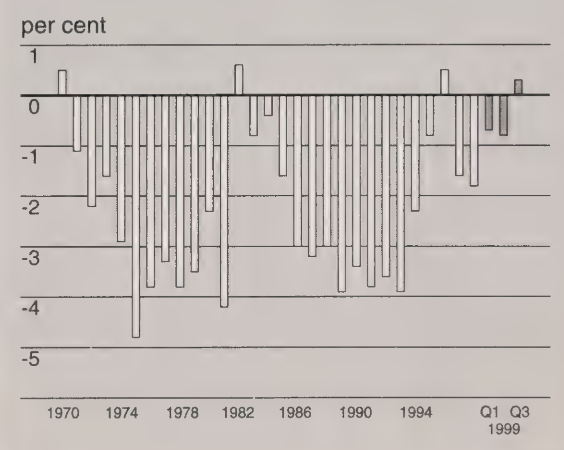
Inventory accumulation smaller

Businesses increased their inventories by $2.9 billion in the third quarter following a much larger accumulation of $7.7 billion in the second quarter. With stronger demand boosting sales, the economy-wide inventory-to-sales ratio dropped to its lowest recorded level.

Current account moves to a surplus

An improvement in the real merchandise trade balance dominated a small deterioration in the terms of trade, yielding a much greater nominal merchandise trade surplus than in the second quarter. This produced an improvement in the current account, which moved from a deficit of $7 billion to a surplus of $2.6 billion, or 0.3% of nominal GDP (Chart 2). Over the past 30 years, the current account has generally been in deficit.

Chart 2
Current account as a percentage of nominal GDP



Inflation subdued while profits soar

Underlying price and cost pressures remained subdued in the third quarter. The implicit and chain price indices for GDP were both somewhat over 2% above their year earlier levels. Consumer prices accelerated to 2.6% in September on a year-over-year basis, owing in part to the temporary impact of higher energy prices. They then eased back to 2.3% in October.

Labour productivity, measured as output per employed person, rose noticeably again in the third quarter. Labour costs per unit of output rose only slightly from their second quarter level and were modestly above their level of a year earlier.

Pre-tax corporate profits surged another 49.6%, the fourth consecutive double-digit increase. The gains in the quarter were widespread among industries, with notable advances in petroleum and gas, transportation, telecommunications, motor vehicles and banks. Profits rose to 10.6% of nominal GDP and to a level 25.9% above that of a year earlier.

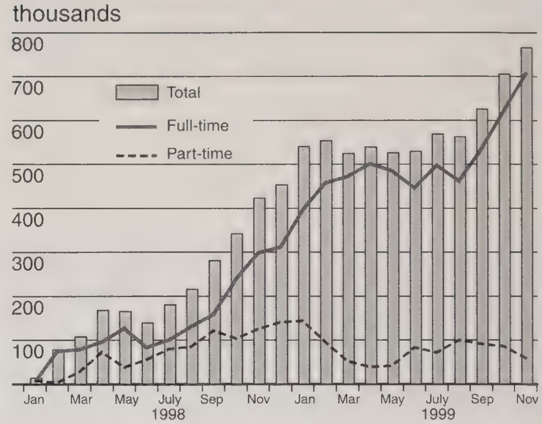
Lowest unemploment rate in 18 years

Third quarter employment increased 1.5% after declining slightly in the second quarter. Employment surged by another 60,000 jobs in November for a three-month gain of over 200,000 jobs (Chart 3). This brought the level to over 310,000 above that at the end of 1998. Full-time jobs have accounted for more than the total net gain. The unemployment rate in November was 6.9%, the lowest rate since August 1981.

The Canadian dollar experiences modest gains

After trading around 65 cents U.S. in the last quarter of 1998, the Canadian dollar strengthened along with world commodity

Chart 3
Cumulative employment growth since December 1997



prices. It peaked near 69 cents U.S. in early May before losing ground to trade near 67 cents U.S. It has since rebounded somewhat and on December 2 closed at 67.49 cents U.S.

Since May, Canadian market interest rates have risen along with those in the United States. Most recently, the U.S. Federal Reserve raised the target for the federal funds rate from 5.25% to 5.50% on November 16, its third round of monetary tightening in 1999. These moves were aimed at staving off inflationary pressures that might arise from a tight U.S. labour market, continued strong U.S. domestic demand and firming foreign economies.

The Bank of Canada matched the November increase by the Federal Reserve. However, interest rates in Canada have generally remained below those in the United States, especially short-term rates.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE MARCH 2000

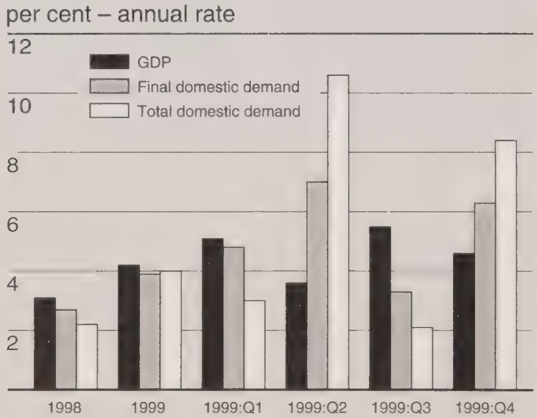
KEY MESSAGES

- In the fourth quarter of 1999, real gross domestic product (GDP) grew sharply, rising 4.6% following an even larger gain of 5.5% in the third quarter. This brought output to 4.7% above its level a year earlier. For 1999 as a whole, the increase in real GDP was 4.2%.
- Demand growth in the quarter was strong and balanced. Both domestic and foreign demand rose robustly, boosting Canadian production. Total domestic demand growth strengthened to 8.4%, with particularly sharp increases in machinery and equipment and inventory investment. Real export growth moderated to a still strong 7.4%. That plus stronger import growth to satisfy the increased demand, especially in categories with a high import content such as machinery and equipment and inventory investment, led to a drop in net exports, detracting from output growth in the fourth quarter.
- The nominal trade surplus decreased noticeably despite a gain in the terms of trade (import prices fell). The current account deteriorated from a surplus of about $2 billion in the third quarter to a deficit of about $5 billion, or 0.5% of nominal GDP, in the fourth. However, this is still a marked improvement relative to the average deficit of 1.8% of nominal GDP in 1998, with the current account deficit for 1999 as a whole standing at $4.3 billion, about one quarter its 1998 level.
- With over 427,000 net new jobs created during 1999, a further gain of about 44,000 in January 2000 brought net job creation to over 471,000 since the end of 1998. Full-time jobs accounted for more than the total net gain. The unemployment rate in January 2000 remained at 6.8%, the lowest rate dating back to April 1976.

SUMMARY[1]

In the fourth quarter of 1999, the Canadian economy continued its robust performance, with both increased domestic and foreign demand. Total domestic demand (spending by Canadian consumers, business and government on goods, services, housing and plant and equipment plus inventory accumulation) growth was stronger than in the third quarter (Chart 1). But export growth slowed and with imports satisfying a larger part of the growing domestic demand than in the third quarter, overall growth was below that in the third quarter. Meanwhile, cost and inflation pressures remained subdued.

Chart 1
Growth in real GDP and real domestic demand



Final domestic demand is spending by Canadians on goods, services, housing and plant and equipment. Total domestic demand is final domestic demand plus inventory accumulation.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is February 28, 2000.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1998	1999	1999:Q2	1999:Q3	1999Q:4	Most recent	
Real gross domestic product	3.1	4.2	3.6	5.5	4.6	–	
GDP excluding inventories	3.6	4.1	0.3	6.8	2.5	–	
Final domestic demand	2.7	3.9	7.0	3.3	6.3	–	
Government expenditure	2.0	1.8	2.1	2.3	3.6	–	
Consumer expenditure	2.8	3.2	4.8	3.9	3.8	–	
Residential investment	-1.9	6.5	15.8	3.9	8.1	–	
Business fixed investment	5.7	10.4	23.1	2.0	21.9	–	
Non-residential construction	0.1	2.8	3.3	3.6	9.3	–	
Machinery and equipment	9.5	14.9	35.6	1.2	29.1	–	
Business inventory change[1]	-0.4	0.1	3.3	-1.2	2.0	–	
Trade balance[1]	1.0	0.2	-5.8	3.3	-4.5	–	
Exports	8.2	9.7	1.2	15.0	7.4	–	
Imports	5.8	9.7	18.6	6.5	21.2	–	
Current account balance							
(nominal $ billion)	-16.4	-4.3	-8.0	2.1	-5.0	–	
(percentage of GDP)	-1.8	-0.5	-0.9	0.2	-0.5	–	
Real personal disposable income	2.4	2.3	3.4	2.3	4.0	–	
Profits before taxes	-6.0	25.2	28.4	58.4	35.1	–	
Costs and prices (%, y/y)							
GDP price deflator	-0.6	1.7	0.9	2.5	3.1	–	
Consumer price index	0.9	1.7	1.6	2.2	2.4	2.3	2000-Jan
CPI – excluding food and energy	1.3	1.5	1.5	1.6	1.6	1.4	2000-Jan
Unit labour costs	0.9	0.3	-0.2	0.5	1.0		
Wage settlements (total)	1.7	2.2	2.4	2.3	2.9	2.3	99-Dec
Labour market							
Unemployment rate (%)	8.3	7.6	7.8	7.6	7.0	6.8	2000-Jan
Employment growth	2.7	2.8	2.5	2.2	3.5	3.7	2000-Jan
Financial markets (average)							
Exchange rate (cents U.S.)	67.48	67.32	67.90	67.30	67.90	68.91	28-Feb-2000
Prime interest rate (%)	6.60	6.44	6.33	6.25	6.42	6.75	28-Feb-2000

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Canadians go shopping

Real consumer expenditure increased a solid 3.8% in the fourth quarter, only slightly off the pace of the previous two quarters. The gain in spending on durables, such as automotive products and furniture and appliances, moderated from its very strong pace but growth in spending on services doubled its pace of the previous quarter.

Personal income grew 4.8% in the fourth quarter, about the same pace as in the third. Labour income growth picked up modestly as growth in employment was much stronger than in the third quarter.

With personal income taxes rising at a slower pace than in the previous quarter and marginally slower than personal income, real personal disposable income growth jumped

to 4.0%.But with continued strong growth in consumer spending, the personal savings rate remained unchanged at 1.1%.

Investment activity rockets

Business investment in plant and equipment soared 21.9% in the fourth quarter, a much stronger pace than in the previous quarter. Investment in machinery and equipment and non-residential construction both grew significantly faster than in the third quarter. Machinery and equipment investment jumped nearly 30% after a very modest rise in the previous quarter, with virtually all major categories registering significant gains. Non-residential construction rose about 9%, with a strong gain in engineering projects being moderated by a drop in building construction.

Residential investment growth also more than doubled its pace in the previous quarter. Increased housing starts boosted new construction activity while renovations also registered a substantial gain following a decline in the third quarter. These more than offset a sharp decline in transfer costs, as sales of existing houses fell in the fourth quarter.

Inventory investment jumps

Businesses raised their inventories by $9.1 billion in the fourth quarter following an accumulation of $4.9 billion in the third quarter. With stronger demand boosting sales relatively more than the increase in inventories, the economy-wide inventory-to-sales ratio nonetheless dropped to its lowest recorded level.

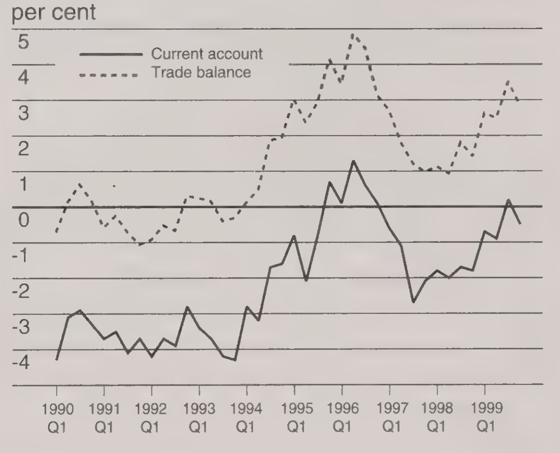
Exports up but imports up more

Increased foreign demand for Canadian products contributed to a gain of 7.4% in real exports in the fourth quarter. A major factor behind rising exports has been strong growth in the United States economy and the ongoing recovery in countries affected by the financial crisis of 1997-1998. Meanwhile, total real imports by Canadians rose 21.2% in the fourth quarter, reflecting the jumps in consumer spending on goods and business investment in machinery and equipment and inventories.

Current account deficit smaller in 1999

A deterioration in the real merchandise trade balance dominated an improvement in the terms of trade, yielding a smaller nominal merchandise trade surplus than in the third quarter. This resulted in the current account moving from a surplus of $2.1 billion to a deficit of $5.0 billion, or 0.5% of nominal GDP (Chart 2). Nonetheless, this is a considerably smaller deficit than those seen in 1997 and 1998. Indeed, the current account deficit for 1999 as a whole was only about one quarter that of 1998.

Chart 2
Current account as a percentage of nominal GDP



Inflation subdued while profits jump again

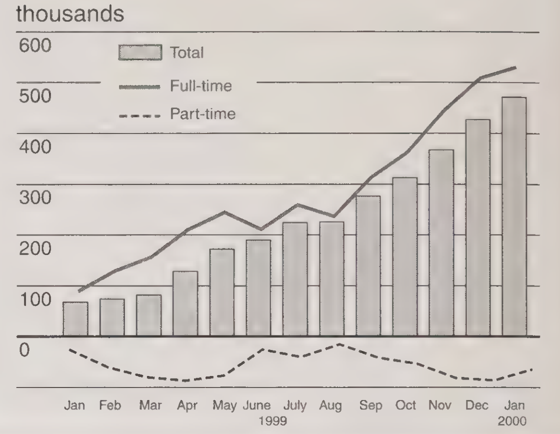
Underlying price and cost pressures remained subdued in the fourth quarter. The implicit and chain price indices for GDP both advanced somewhat more than 3% over the last four

quarters. Consumer price inflation ticked up to 2.6% in September on a year-over-year basis and again in December, owing in part to the temporary impact of higher energy prices. CPI inflation eased back to 2.3% in January.

Labour productivity, measured as output per employed person, rose again in the fourth quarter, although at a slower pace than in the third. Labour costs per unit of output rose modestly from their third quarter level and were 1.0% above their level of a year earlier.

Pre-tax corporate profits surged another 35.1%, the fifth consecutive double-digit increase. The gains in the quarter were widespread among industries, with both financial and non-financial corporations showing solid gains. Profits rose to 11.8% of nominal GDP and to a level 38.7% above that of a year earlier.

Chart 3
Cumulative employment growth since December 1998



Lowest unemployment rate in 24 years

Fourth quarter employment increased 3.5%, with over 427,000 net new jobs created during 1999. A further 44,000 net new jobs were created in January 2000 for a six-month gain of nearly 250,000 jobs (Chart 3). This raised the total increase to over 471,000 jobs since the end of 1998. Full-time jobs grew even faster, exceeding the total net gain as part-time employment fell. The unemployment rate in January 2000 remained at 6.8%, the lowest rate since April 1976.

The Canadian dollar maintains gains

After trading around 65 cents U.S. in the last quarter of 1998, the Canadian dollar strengthened along with world commodity prices. It peaked near 69 cents U.S. in early May before losing ground to trade near 67 cents U.S. It has since rebounded to near 69 cents U.S. On February 28, it closed at 68.91 cents U.S.

Since May, Canadian market interest rates have risen along with those in the United States. Most recently, on February 26 the U.S. Federal Reserve raised the target for the Federal Funds Rate from 5.50% to 5.75%, its fourth round of monetary tightening since mid-June 1999. These moves were aimed at staving off inflationary pressures that might arise from a tight U.S. labour market, continued strong U.S. domestic demand and firming foreign economies.

The Bank of Canada matched the February increase by the Federal Reserve, as it had in November 1999. However, interest rates in Canada have generally remained below those in the United States, especially short-term rates. The differential between Canadian and U.S. 3-month Treasury bill yields widened from under 40 basis points in mid-November 1999 to over 80 basis points on February 28, 2000.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2000

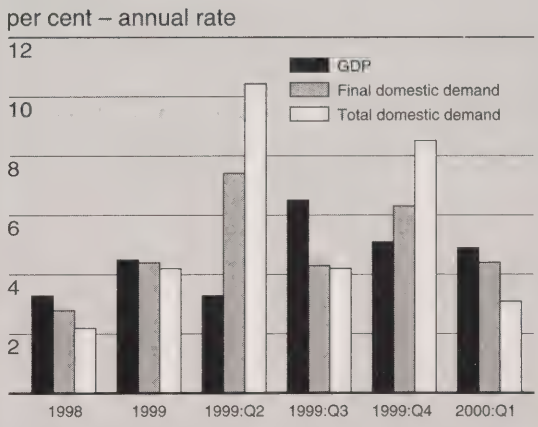
KEY MESSAGES

- In the first quarter of 2000, real gross domestic product (GDP) grew a robust 4.9% following even stronger gains of 6.5% and 5.1% in the third and fourth quarters of 1999. This brought output to 4.9% above its level a year earlier. At the same time, the first quarter of the new millennium saw nominal GDP surpass the trillion dollar mark for the first time.
- Growth in both foreign and domestic demand contributed to increased output. Total domestic demand grew less rapidly than in the fourth quarter. However, real exports jumped 13.9%, boosting Canadian production.
- The nominal trade surplus increased significantly as both the real trade balance and the terms of trade improved (export prices rose while import prices fell). The current account moved from a deficit of about $1 billion in the fourth quarter to a surplus of over $19 billion, or 1.9% of nominal GDP, in the first quarter. This is the highest current account surplus ever both in dollar terms and as a share of nominal GDP. This continued a trend begun several quarters earlier, as the average deficit stood at 1.8% of nominal GDP in 1998 and 0.4% in 1999.
- The strong pace of job creation has continued into 2000. A gain of 115,000 net new jobs from January to April on top of the 427,000 created during 1999 brought net job creation to over 542,000 since the end of 1998. Full-time jobs accounted for more than the total net gain. The unemployment rate in April 2000 remained at 6.8% for the fifth consecutive month, the lowest rate since April 1976.

SUMMARY[1]

In the first quarter of 2000, the Canadian economy continued its solid growth, with both increased foreign and domestic demand. Export growth jumped while imports satisfied a smaller part of growing domestic demand than in the fourth quarter, providing a boost to Canadian production. Total domestic demand (spending by Canadian consumers, business and government on goods, services, housing and plant and equipment plus inventory accumulation) growth continued but at a slower pace than in the fourth quarter (Chart 1), restraining growth to a rate similar to that in the fourth quarter. Meanwhile, cost and inflation pressures remained subdued.

Chart 1
Growth in real GDP and real domestic demand



Final domestic demand is spending by Canadians on goods, services, housing and plant and equipment. Total domestic demand is final domestic demand plus inventory accumulation.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates and the cut-off date for data is May 31, 2000.

Department of Finance Canada   Ministère des Finances Canada
Canada

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1998	1999	1999:Q2	1999:Q3	1999:Q4	2000:Q1	Most recent	
Real gross domestic product	3.3	4.5	3.3	6.5	5.1	4.9		–
GDP excluding inventories	3.9	4.7	0.6	6.6	3.0	6.2		–
Final domestic demand	2.8	4.4	7.4	4.3	6.3	4.4		–
Government expenditure	1.6	2.8	3.8	3.3	3.8	1.5		–
Consumer expenditure	2.9	3.5	4.7	4.6	3.7	3.4		–
Residential investment	-2.0	6.6	11.7	4.8	12.1	9.8		–
Business fixed investment	6.1	10.5	25.3	4.8	20.5	11.2		–
Non-residential construction	1.7	2.0	0.0	2.5	8.6	12.5		–
Machinery and equipment	9.0	15.6	41.9	6.0	27.2	10.5		–
Business inventory change[1]	-0.5	-0.2	2.7	-0.1	2.0	-1.1		–
Trade balance[1]	1.1	0.4	-5.5	2.5	-3.6	2.5		–
Exports	8.9	10.0	0.4	12.9	10.7	13.9		–
Imports	6.1	9.4	16.7	6.5	22.1	7.9		–
Current account balance								
(nominal $ billion)	-16.3	-3.4	-7.2	1.7	-1.3	19.4		–
(percentage of GDP)	-1.8	-0.4	-0.8	0.2	-0.1	1.9		–
Real personal disposable income	2.8	2.7	4.0	1.9	3.4	4.5		–
Profits before taxes	-5.6	23.7	23.6	59.8	27.0	31.5		–
Costs and prices (%, y/y)								
GDP price deflator	-0.6	1.6	1.0	2.5	3.1	3.3		–
Consumer price index	0.9	1.7	1.6	2.2	2.4	2.7	2.1	Apr-2000
CPI – excluding food and energy	1.3	1.5	1.5	1.6	1.6	1.5	1.3	Apr-2000
Unit labour costs	1.4	0.5	0.4	0.5	0.8	1.6	1.9	Mar-2000
Wage settlements (total)	1.7	2.2	2.4	2.3	2.9	2.3	2.5	Mar-2000
Labour market								
Unemployment rate (%)	8.3	7.6	7.8	7.6	7.0	6.8	6.8	Apr-2000
Employment growth	2.7	2.8	2.5	2.2	3.5	3.8	0.4	Apr-2000
Financial markets (average)								
Exchange rate (cents U.S.)	67.48	67.32	67.90	67.30	67.90	68.80	67.05	01-Jun-2000
Prime interest rate (%)	6.60	6.44	6.33	6.25	6.42	6.75	7.50	01-Jun-2000

[1] Annualized change expressed as a percentage of GDP in the previous period.

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Canadians still buying

Real consumer expenditure increased a solid 3.4% in the first quarter, modestly off the pace of the previous quarter. The pace of growth for spending on durables, such as furniture and appliances, increased relative to the previous quarter, but the pace of growth for spending on non-durables and services slowed. The slowdown for non-durables in part reflected a return to more normal spending on food, which had spiked in December due to Y2K concerns and millennium celebrations.

The 5.8% gain in personal income was faster than in the fourth quarter. Labour income registered its strongest quarterly growth rate since the late 1980s. Employment gains were similar to those in the fourth quarter while hours worked increased more sharply.

With personal income taxes rising only modestly faster than in the previous quarter, real personal disposable income growth rose to 4.5%. On a per capita basis, real personal disposable income grew 4.1%, continuing a positive trend. And with disposable income outgrowing consumer spending, the personal savings rate rose to 3.4% from an upwardly revised 3.2% in the fourth quarter. Changes in Statistics Canada's treatment of public service pension plans, as well as historical revisions to income and outlays, raised the savings rate by between one and three percentage points since 1961.

Investment activity continues to grow

Business investment in plant and equipment increased a robust 11.2% in the first quarter. However, this was slower than the pace in the previous quarter. Machinery and equipment investment grew 10.5% after a much sharper gain in the previous quarter. Non-residential construction growth, at 12.5%, increased faster than in the fourth quarter, with significant gains in engineering projects, as higher energy prices boosted oil patch activity.

Residential investment growth was strong in the first quarter but slower than in the fourth. Renovations posted a second consecutive solid gain of nearly 20% while transfer costs rebounded sharply from a decline in the previous quarter, as sales of existing houses jumped. However, growth in new construction activity slowed sharply despite a modest increase in housing starts.

Inventories rise more modestly

Businesses raised their inventories by $6.6 billion in the first quarter following a larger accumulation of $9.2 billion in the fourth. With stronger demand boosting sales more than the increase in inventories, the economy-wide inventory-to-sales ratio dropped to its lowest recorded level.

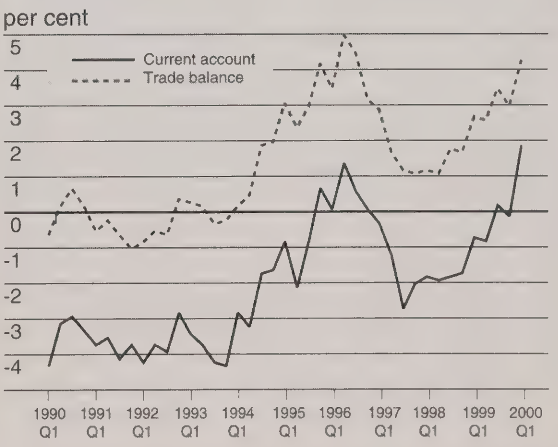
Surge in exports boosts production

Increased foreign demand for Canadian products raised real exports 13.9% in the first quarter. A dominant factor behind rising exports has been solid external demand arising from strong growth in the United States economy and the ongoing recovery in nations affected by the financial crisis of 1997-1998. Meanwhile, total real imports by Canadians rose a more moderate 7.9% in the first quarter, reflecting the more modest gains in consumer spending and business investment in machinery and equipment and inventories than in the previous quarter.

Record current account surplus

The gain in the real trade balance plus an improvement in the terms of trade resulted in a much larger nominal trade surplus than in the fourth quarter. This, along with improvements in the investment income deficit (including net retained earnings) and net transfers, moved the current account from a deficit of about $1 billion in the fourth quarter to a record surplus of over $19 billion, or 1.9% of nominal GDP, in the first quarter (Chart 2). This continued the improvement in the current account, which registered a much smaller deficit in 1999 than in 1997 and 1998.

Chart 2
Current account as a percentage of nominal GDP



Inflation rises temporarily while profits jump again

The implicit and chain price indices for GDP both advanced about 4% in the first quarter, as higher export prices sharply raised these indices to levels over 3% higher than a year earlier. However, consumer price inflation remains moderate. After rising to 3.0% in March on a year-over-year basis, largely due to the temporary impact of higher energy prices, CPI inflation eased to 2.1% in April as energy prices retreated. Moreover, underlying CPI inflation, which excludes food and energy prices, posted only a modest year-over-year increase of 1.3% in April.

Labour productivity, measured as output per employed person, rose slightly slower in the first quarter than in the fourth. Labour costs per unit of output rose from their fourth quarter level and were 1.6% above their level of a year earlier.

Pre-tax corporate profits surged 31.5%, the sixth consecutive double-digit increase. Profits rose to 12.0% of nominal GDP and to a level 34.8% above that of a year earlier.

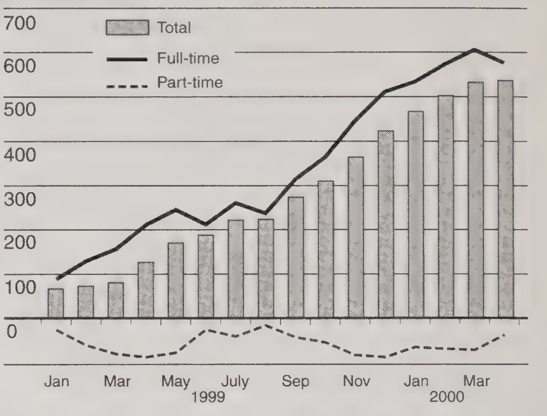
Unemployment rate remains at 24-year low

First quarter employment increased 3.8%, adding to the over 427,000 net new jobs created during 1999. Even with the modest employment gain in April, the number of net new jobs created in the six months since October 1999 stood at 229,000 (Chart 3). This raised the total increase to over 542,000 jobs since the end of 1998. And despite a drop in April, full-time jobs have exceeded the total net gain as part-time employment fell over that period. The unemployment rate in April 2000 remained at 6.8%, the lowest rate since April 1976.

The Canadian dollar gives back some gains

After dropping to an all-time low close of 63.31 cents U.S. in late August 1998, the Canadian dollar rebounded along with world

Chart 3
Cumulative employment growth since December 1998



commodity prices. It rose above 69 cents U.S. on several occasions, most recently in early March. It has since lost some ground to trade below 67 cents U.S. On June 1, it closed at 67.05 cents U.S.

Canadian market interest rates have risen along with those in the United States. Most recently, on May 16, the U.S. Federal Reserve tightened monetary conditions for the sixth time since mid-June 1999, raising the target for the Federal Funds Rate from 6.00% to 6.50%, bringing the total increase to 175 basis points. The Bank of Canada matched the May increase by the Federal Reserve, as it had in February 2000 and November 1999.

However, interest rates in Canada generally have remained below those in the United States, especially short-term rates. The differential between Canadian and U.S. 3-month Treasury bill yields widened from under 40 basis points in mid-November 1999 to over 90 basis points at the beginning of March. More recently, short-term rates in the two countries have converged, with the Canadian yield only 7 basis points below that of the U.S. on June 1.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Mostafa Askari at (613) 992-3055.
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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 2000

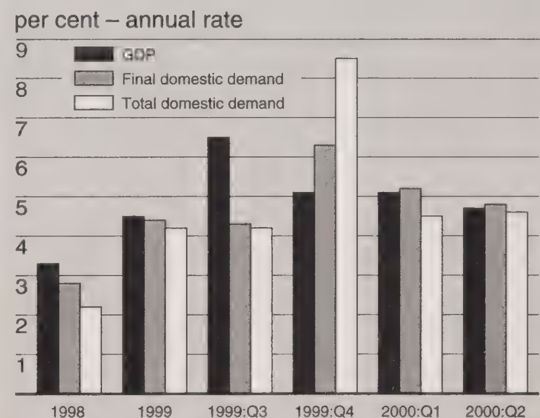
KEY MESSAGES

- In the second quarter of 2000, real gross domestic product (GDP) increased 4.7%, another robust gain following even stronger growth rates of 5.1% in the previous two quarters and 6.5% in the third quarter of 1999. This brought output to 5.3% above its level a year earlier. Investment and trade in high tech products dominated growth in the quarter.
- Both domestic and foreign demand boosted production. Total domestic demand (spending by consumers, business and government on goods, services, housing, plant and equipment and inventory accumulation) increased 4.6%, a pace similar to that of the previous quarter. But foreign demand grew less vigorously than in the earlier quarter: real exports rose 8.5% after jumping 17.5% in the first quarter. However, real import growth, while exceeding that of exports, also weakened, implying that production outside Canada satisfied a smaller part of increased demand than in the earlier quarter.
- The nominal trade surplus fell as both the real trade balance and the terms of trade deteriorated (export prices rose less than import prices). The current account, at $14.3 billion, or 1.4% of nominal GDP, registered a second consecutive large surplus, although it was below the record high achieved in the first quarter.
- Despite modest declines in June and July, net job creation over the past year has been impressive. Employment in July was almost 330,000 above the level of July 1999. The unemployment rate in July 2000 was 6.8%, up modestly from 6.6% in the two previous months.

SUMMARY[1]

In the second quarter of 2000, the Canadian economy continued its solid growth, the 20th consecutive quarterly gain and the longest uninterrupted string of advances since the mid-1960s. Both increased foreign and domestic demand boosted Canadian production. However, growth in foreign demand slowed from its first-quarter pace, reducing overall real GDP growth relative to the previous quarter (Chart 1).

Chart 1
Growth in real GDP and real domestic demand



Final domestic demand is spending by Canadians on goods, services, housing, plant and equipment. Total domestic demand is final domestic demand plus inventory accumulation.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is August 31, 2000.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1998	1999	1999:Q4	2000:Q1	2000:Q2	Most recent	
Real gross domestic product	3.3	4.5	5.1	5.1	4.7		–
GDP excluding inventories	3.9	4.7	3.0	5.8	4.9		–
Final domestic demand	2.8	4.4	6.3	5.2	4.8		–
Government expenditure	1.6	2.8	3.8	5.1	2.8		–
Consumer expenditure	2.9	3.5	3.7	3.4	3.6		–
Residential investment	-2.0	6.6	12.1	0.6	-11.0		–
Business fixed investment	6.1	10.5	20.5	15.4	19.5		–
Non-residential construction	1.7	2.0	8.6	10.2	2.9		–
Machinery and equipment	9.0	15.6	27.2	18.1	28.5		–
Business inventory change[1]	-0.5	-0.2	2.0	-0.6	-0.2		–
Trade balance[1]	1.1	0.4	-3.6	1.3	-0.5		–
Exports	8.9	10.0	10.7	17.5	8.5		–
Imports	6.1	9.4	22.1	14.7	10.2		–
Current account balance							
(nominal $ billion)	-16.3	-3.4	-1.3	19.4	14.3		–
(percentage of GDP)	-1.8	-0.4	-0.1	1.9	1.4		–
Real personal disposable income	2.8	2.7	3.4	6.6	6.0		–
Profits before taxes	-5.6	23.7	27.0	35.1	11.3		–
Costs and prices (%, y/y)							
GDP price deflator	-0.6	1.6	3.1	3.6	3.1		–
Consumer price index	0.9	1.7	2.4	2.7	2.4	3.0	Jul-2000
CPI – excluding food and energy	1.3	1.5	1.6	1.5	1.4	1.5	Jul-2000
Unit labour costs	1.4	0.5	0.8	1.8	2.3		
Wage settlements (total)	1.7	2.2	2.9	2.3	2.5	2.7	Jul-2000
Labour market							
Unemployment rate (%)	8.3	7.6	7.0	6.8	6.7	6.8	Jul-2000
Employment growth	2.7	2.8	3.5	3.8	1.6	-1.4	Jul-2000
Financial markets (average)							
Exchange rate (cents U.S.)	67.48	67.32	67.90	68.80	67.56	67.96	31-Aug-2000
Prime interest rate (%)	6.60	6.44	6.42	6.75	7.33	7.50	31-Aug-2000

[1] Annualized change expressed as a percentage of GDP in the previous period.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Canadians purchase more

Real consumer expenditure increased 3.6% in the second quarter, a pace slightly above that of the previous quarter. Spending on services jumped (5.0% versus 1.7% in the first quarter) but growth slowed for expenditures on goods, including durables (3.6%, down from 9.4%). Nonetheless, the pace of increase for durables spending remained healthy.

The gain in personal income (7.9%) was virtually the same as in the first quarter. Labour income registered its strongest growth rate in over 12 years, despite reduced employment gains compared to the first quarter, as the significant pay equity settlement of the federal government sharply boosted this income component.

With personal income taxes rising modestly faster than in the previous quarter, real personal disposable income rose 6.0%, aided by the boost from the pay equity settlement. A recent positive trend has now raised real personal disposable income per capita to a record high. And with disposable income outgrowing nominal consumer spending, the personal savings rate rose to 4.4% from 3.9% in the first quarter.

Investment activity continues strong growth

Business investment in plant and equipment grew faster than in the first quarter, rising 19.5%. Machinery and equipment investment increased sharply by 28.5%, as growth in computers and other office equipment was particulary strong. But non-residential construction growth moderated, with slowdowns in both building and engineering projects.

Residential investment fell in the second quarter. Growth in new construction activity dropped sharply along with housing starts, due partly to a cement truck drivers' strike in the Toronto area. Transfer costs also declined, as sales of existing houses fell slightly from the high level of the previous quarter. Meanwhile, growth in renovations slowed.

Inventory accumulation little changed

Inventory accumulation in the quarter was slightly off that in the first quarter. Businesses raised inventories $7.5 billion following an increase of $7.8 billion in the first quarter. With increased demand boosting sales relatively more than inventories, the economy-wide inventory-to-sales ratio dropped to its lowest recorded level.

Foreign demand boosts production

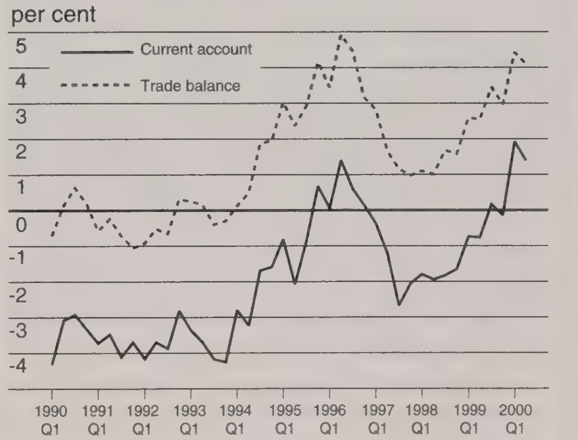
Increased foreign demand boosted real exports from Canada 8.5% in the second quarter, a slower pace than in the first. A dominant factor behind rising exports has been strong growth in the United States and the recovery in nations affected by the financial crisis of 1997-1998. The slowdown in the quarter was largely due to reduced exports of automotive products, consistent with declining motor vehicle sales in the United States.

Meanwhile, growth in total real imports (10.2%) by Canadians outpaced that of exports but was more modest than in the first quarter. This reflected reduced imports of automotive products because of slow growth in sales of vehicles in Canada and less need to import parts to assemble vehicles, due to declining automotive exports to the United States in the quarter.

Another large current account surplus

At $14.3 billion, or 1.4% of nominal GDP, the second-quarter current account surplus was below the record $19.4-billion surplus, or 1.9% of nominal GDP, set in the first quarter (Chart 2). Deteriorations in the real merchandise trade balance, the terms of trade and the travel deficit resulted in a smaller nominal trade surplus than in the first quarter. Along with a worsening in the investment income (especially net retained earnings) deficit and in the net transfers surplus, this yielded a smaller but still large current account surplus in the second quarter. However, the trend has been to a sharply improved current account, which registered deficits of 1.8% of nominal GDP in 1998 and 0.4% in 1999.

Chart 2
Current account as a percentage of nominal GDP



Inflation subdued as productivity jumps

Underlying price and cost pressures remain subdued. The implicit and chain price indices for GDP advanced in the second quarter to levels 3.1% and 3.9% higher than a year earlier. These increases partly reflect the temporary impacts of the pay equity settlement and higher energy prices. And consumer price inflation rose to 3.0% in July on a year-over-year basis, but again the increased pace is largely due to higher energy prices. Core inflation, which excludes food and energy, was only 1.5% in the month on a year-over-year basis.

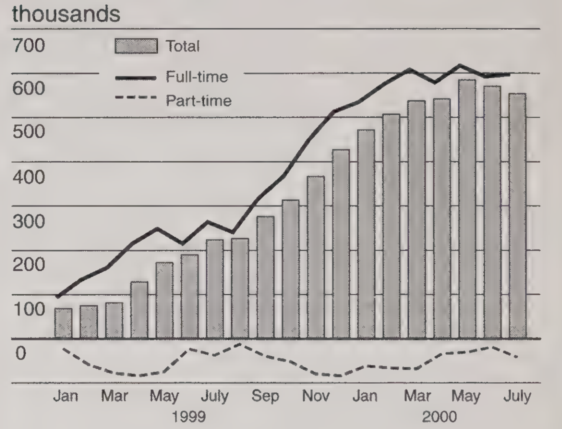
Labour productivity registered a sharper gain in the second quarter than in the first. Despite that, labour costs per unit of output rose noticeably and were 2.3% above their level of a year earlier. But again, much of this is attributable to the temporary impact of the pay equity settlement, which sharply boosted labour income in the quarter.

Pre-tax corporate profits rose 11.3%, the seventh consecutive double-digit increase, to a level 32.2% above that of a year earlier. Profits increased to 12.2% of nominal GDP. The gains were most notable in oil and gas extraction (given higher energy prices), transportation services (given increased shipments and travel in a robustly growing economy), and automotive manufacturing.

Unemployment remains low

Second-quarter employment growth eased to 1.6%, less than half the pace of the first quarter. Nonetheless, even with modest losses in June and July, 126,000 net new jobs have been created so far in 2000 (Chart 3). The total increase since July of 1999 stands at 329,000 jobs. And full-time jobs accounted for the total net gain. The unemployment rate in July 2000 increased modestly to 6.8% from 6.6% in May and June.

Chart 3
Cumulative employment growth since December 1998



The Canadian dollar regains some ground

After trading below 67 cents U.S. during the second half of May, the Canadian dollar increased in value to above 68 cents U.S. in late July before easing back. The dollar closed at 67.96 cents U.S. on August 31.

In recent months, the U.S. Federal Reserve and the Bank of Canada have monitored the impacts of the monetary tightening aimed at staving off inflationary pressures, given tighter labour markets, continued strong domestic demands and firming overseas economies. While administered interest rates have remained steady since the end of May, short-term market interest rates in the United States have increased somewhat while long rates have declined. Long-term interest rates in Canada have declined as well, although not as much as in the United States, while short rates have shown little trend. As a result, interest rates in Canada have generally remained below those in the United States, especially short-term rates. The differential between Canadian and U.S. 3-month Treasury bill yields has moved from near zero at the end of May to near 70 basis points at the end of August.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE DECEMBER 2000

KEY MESSAGES

- In the third quarter of 2000, real gross domestic product (GDP) again increased robustly, rising 4.8%. This was the fifth consecutive quarter of growth above 4.5% and it brought output to 5.0% above its level a year earlier.
- Domestic demand boosted Canadian production. Real final domestic demand (spending by consumers, business and government on goods, services, housing, plant and equipment) increased 5.9%, a similar pace to that in the second quarter. Inventory accumulation was greater than in the second quarter, but foreign demand declined modestly with real exports off 0.5%, partly reflecting the slowdown in the United States. Meanwhile, real import growth weakened to 5.9% from 11.8% in the second quarter, implying that production outside Canada satisfied a smaller part of the increased domestic demand than in the previous quarter.
- The nominal trade surplus fell as the real trade surplus declined to 60% of its second-quarter level. The drop in the nominal surplus, however, was moderated by a sharp gain in the terms of trade (export prices rose while import prices fell). The current account, at $13.5 billion and 1.3% of nominal GDP, registered a third consecutive large surplus.
- Net job creation has been impressive. Employment in November 2000 was more than 715,000 above the level at the end of 1998. The unemployment rate in November was 6.9%, the same as in October.

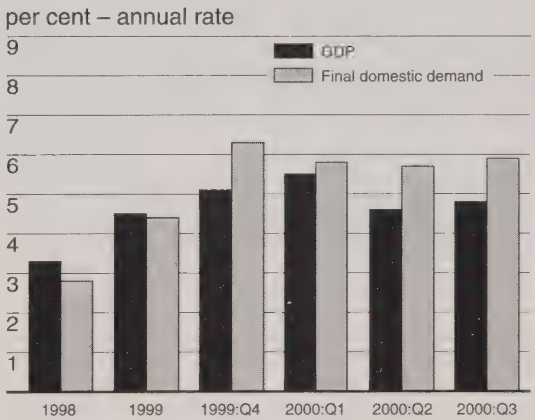
SUMMARY[1]

In the third quarter of 2000, the Canadian economy continued its solid growth, the 21st consecutive quarterly gain and the longest uninterrupted string of advances since the mid-1960s. Increased domestic demand provided the boost to Canadian production, as foreign demand eased back (Chart 1).

Consumer spending strong and durable

Real consumer expenditure increased at a stronger pace than in the second quarter, rising 5.5%. While gains were widespread, spending on durables was especially strong, surging

Chart 1
Growth in real GDP and real final domestic demand



Note: Final domestic demand is spending by Canadians on goods, services, housing, plant and equipment.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, December 1, 2000.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1998	1999	2000:Q1	2000:Q2	2000:Q3	Most recent	
Real gross domestic product	3.3	4.5	5.5	4.6	4.8		–
GDP excluding inventories	3.9	4.7	6.0	4.9	3.0		–
Final domestic demand	2.8	4.4	5.8	5.7	5.9		–
Government expenditure	1.6	2.8	5.8	4.7	4.0		–
Consumer expenditure	2.9	3.5	4.0	3.6	5.5		–
Residential investment	-2.0	6.6	2.3	-9.4	6.0		–
Business fixed investment	6.1	10.5	15.1	22.9	10.5		–
Non-residential construction	1.7	2.0	10.3	2.8	-0.5		–
Machinery and equipment	9.0	15.6	17.6	34.0	16.0		–
Business inventory change[1]	-0.5	-0.2	-0.4	-0.3	1.7		–
Trade balance[1]	1.1	0.4	0.3	-0.8	-2.6		–
Exports	8.9	10.0	15.5	9.3	-0.5		–
Imports	6.1	9.4	15.4	11.8	5.9		–
Current account balance							
(nominal $ billion)	-16.3	-3.4	18.3	14.4	13.5		–
(percentage of GDP)	-1.8	-0.4	1.8	1.4	1.3		–
Real personal disposable income	2.8	2.7	8.3	3.0	-1.2		–
Profits before taxes	-5.6	23.7	32.6	8.9	4.2		–
Costs and prices (%, y/y)							
GDP price deflator	-0.6	1.6	3.7	3.6	3.4		–
Consumer price index	0.9	1.7	2.7	2.4	2.7	2.8	Oct-2000
CPI – excluding food and energy	1.3	1.5	1.5	1.4	1.5	1.5	Oct-2000
Unit labour costs	1.4	0.5	1.7	2.3	2.2		
Wage settlements (total)	1.7	2.2	2.4	2.5	2.3	2.7	Sep-2000
Labour market							
Unemployment rate (%)	8.3	7.6	6.8	6.7	6.9	6.9	Nov-2000
Employment growth	2.7	2.8	3.8	1.6	0.7	4.8	Nov-2000
Financial markets (average)							
Exchange rates (cents U.S.)	67.48	67.32	68.80	67.56	67.47	64.86	30-Nov-2000
Prime interest rate (%)	6.60	6.44	6.75	7.33	7.50	7.50	30-Nov-2000

[1] Annualized change expressed as a percentage of GDP in the previous period.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

16.3%. Growth in personal spending on automotive products was particularly robust, as manufacturers offered incentives to boost sales of motor vehicles.

The 3.2% gain in personal income was half that in the second quarter. Labour income growth slowed sharply as employment growth moderated and the federal pay equity disbursements were much smaller than in the second quarter. The personal savings rate fell to 2.3% from 3.9% in the second quarter.

Productive capacity continues to grow

Businesses further enhanced their productive capacity in the third quarter, as investment in plant and equipment rose 10.5%. However, growth was more moderate than the 22.9% surge in the second quarter. Following a 34% jump in the second quarter, machinery and equipment investment rose 16%, led by a 50% gain in telecommunications and computers and other office equipment. Non-residential construction, however, declined modestly, with drops in both building and engineering projects.

Residential investment increased 6% in the third quarter following a sharp decline of 9.4% in the second. New construction activity rose along with housing starts, rebounding from a second-quarter strike in the Toronto area. Growth rates for renovations and transfer costs were similar to that for new construction.

Stronger inventory accumulation

Inventory accumulation in the third quarter significantly surpassed that in the second, adding to GDP growth. Business inventories increased $11.6 billion after rising $7.7 billion in the earlier quarter. The greater accumulation largely reflected buildups in motor vehicles produced for the American market and information and communications technology products. But with sales growth just exceeding that of inventories, the inventory-to-sales ratio inched down to a new record low.

Domestic demand boosts Canadian production while foreign demand sags

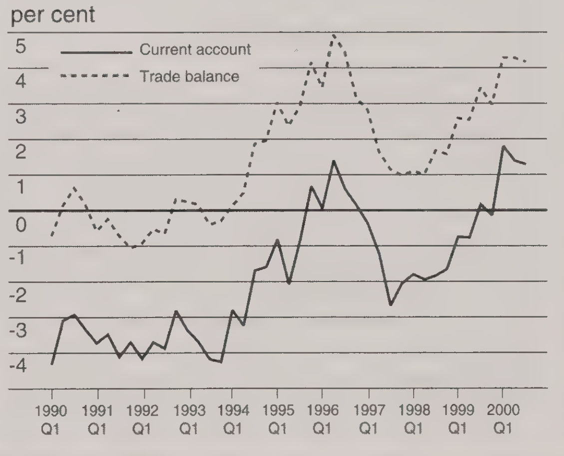
Increased domestic demand raised real imports by 5.9%, half the pace of the second quarter. Imports thus accounted for a smaller part of increased domestic demand than in the previous quarter. This slowdown partly stemmed from the reduced growth in investment in machinery and equipment, an import-intensive category of domestic demand.

Reduced foreign demand for Canadian products, partly reflecting the sharp growth slowdown in the United States to its weakest pace in four years and to only half that in Canada, lowered real exports 0.5% in the third quarter. While there was a sharp growth slowdown in exports of machinery and equipment, especially those of the "new economy," the drop was largely due to reduced exports of automotive and energy products. Energy exports responded negatively to higher world prices. Weaker automotive exports is consistent with the modest growth in U.S. motor vehicle sales in the third quarter after falling sales in the second quarter. With real imports rising and real exports falling modestly, the real trade balance was about 60% of that in the previous quarter.

Another large current account surplus

While the real trade balance was sharply lower, export prices rose and import prices fell. This produced an improvement in the terms of trade of over 5%, leaving the nominal trade surplus at a high level and only about $0.5 billion lower than in the second quarter. However, a deterioration in the transfers balance more than offset an improvement of over $1 billion in the investment income (including retained earnings) deficit. Thus the current account surplus dropped to $13.5 billion, or 1.3% of nominal GDP, from $14.4 billion in the second quarter (Chart 2). While below the record of $18.3 billion (1.8% of nominal GDP) in the first quarter, the continuing large current account surplus represents a substantial improvement from deficits of 1.8% of nominal GDP in 1998 and 0.4% in 1999.

Chart 2
Current account as a percentage of nominal GDP



Inflation subdued as productivity up again

Underlying price and cost pressures remain subdued. The implicit and chain price indices for GDP advanced in the third quarter to levels 3.4% and 4.2% higher than a year earlier. The size of these increases partly reflected the temporary impacts of higher energy prices. And while consumer price inflation remained just below 3.0% in October on a year-over-year basis, the increased pace relative to recent years is again largely due to higher energy prices. Underlying CPI inflation, which excludes food and energy, was only 1.5% in that month on a year-over-year basis.

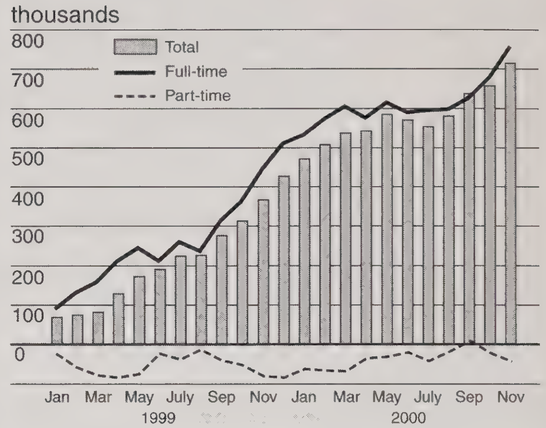
Labour productivity registered another strong gain, one that was larger than those in the first and second quarters: output per hour worked was up nearly 5% in the third quarter while output per employed person rose over 4%. Productivity growth plus smaller pay equity disbursements caused year-over-year unit labour cost growth to slow to 2.2%.

Pre-tax corporate profits rose 4.2%, the eighth consecutive increase, to a level 17.5% above that of a year earlier. Gains were notable for the oil and gas extraction industry, given higher energy prices, and for electronics and computer manufacturers, given strong demand for their products.

Unemployment remains low

Third-quarter employment growth eased further to 0.7% from 1.6% in the second. But with some 58,000 net new jobs created in November, employment has risen by nearly 290,000 so far in 2000 (Chart 3). The total increase since the end of 1998 stands at over 715,000 jobs. Full-time jobs have exceeded the total net gain, as part-time employment fell over that period. The unemployment rate in November 2000 was 6.9%, the same as in October.

Chart 3
Cumulative employment growth since December 1998



The Canadian dollar loses some ground

After trading near 68 cents U.S. in late August, the dollar closed at 64.86 cents U.S. on November 30.

The U.S. Federal Reserve and the Bank of Canada have continued to monitor the impacts of earlier monetary tightening aimed at staving off inflationary pressures. While administered interest rates have remained steady since the end of May, short-term market rates in the United States increased until late August but have shown little trend since. Meanwhile, long rates have continued to trend downward. In Canada, short-term interest rates have risen somewhat since the end of August while long rates have declined, although not as much as in the United States. As a result, short rates in Canada have remained well below those in the United States while long-term rates in the two countries are at similar levels. The differential between Canadian and U.S. 3-month Treasury bill yields generally has remained over 60 basis points since the end of August.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE MARCH 2001

OVERVIEW

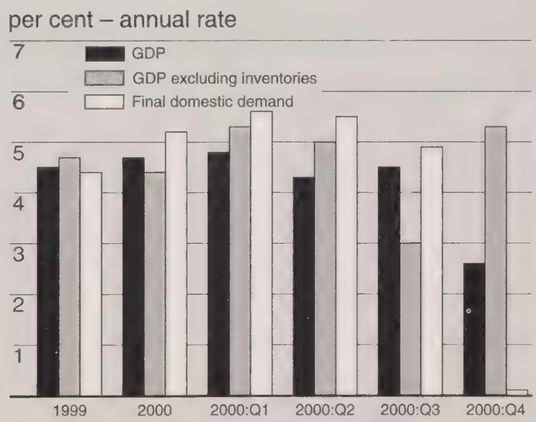
- In the fourth quarter of 2000 real gross domestic product (GDP) continued to expand, although at a slower pace of 2.6% compared to increases above 4% in the previous five quarters. Growth for the year 2000 was 4.7%.
- Real final domestic demand (spending by consumers, business and government on goods, services, housing, plant and equipment) in the fourth quarter was largely unchanged from its third-quarter level. Firms sharply reduced their inventory accumulation, with real GDP excluding inventories rising 5.3%. Domestic demand shifted toward Canadian-made goods and services, with production outside Canada satisfying a smaller part of domestic demand than in the previous quarter. This boosted Canadian output while reducing real imports by 9.8%. Finally, foreign demand grew less rapidly than in the previous quarter, with real exports rising 1.0%.
- The nominal trade surplus jumped to a record level as the real trade surplus doubled its third-quarter level. The gain in the nominal surplus, however, was moderated by a loss in the terms of trade (export prices rose less than import prices). The fourth-quarter current account reached a record $23.4 billion, or 2.2% of nominal GDP. For 2000 as a whole the surplus was $18.9 billion, or 1.8% of nominal GDP, shattering the previous record for a calendar year.
- Despite no gain in January, employment was more than 750,000 above the level at the end of 1998. The unemployment rate in January 2001 was 6.9%.

Real GDP growth continuing but at a slower pace[1]

In the fourth quarter of 2000 the Canadian economy continued its expansion, although at a slower pace than in the previous five quarters. This was the 22nd consecutive quarterly gain and the longest uninterrupted string of advances since the mid-1960s. Real final domestic demand was largely unchanged from its third-quarter level but shifted toward Canadian-produced goods and services, boosting Canadian output while reducing imports (Chart 1). Given slower demand growth, firms sharply reduced their inventory accumulation, with real GDP excluding inventories rising 5.3%.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, March 7, 2001.

Chart 1
Growth in real GDP and real final domestic demand



Note: Final domestic demand is spending by Canadians on goods, services, housing, plant and equipment.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1999	2000	2000:Q2	2000:Q3	2000:Q4	Most recent	
Real gross domestic product	4.5	4.7	4.3	4.5	2.6		–
GDP excluding inventories	4.7	4.4	5.0	3.0	5.3		–
Final domestic demand	4.4	5.2	5.5	4.9	0.1		–
Government expenditure	2.8	3.9	5.1	2.5	0.9		–
Consumer expenditure	3.5	4.0	3.6	5.0	2.3		–
Residential investment	6.6	1.6	-10.9	7.9	-0.5		–
Business fixed investment	10.5	14.0	20.6	7.1	-9.3		–
Non-residential construction	2.0	4.8	1.3	-1.6	4.4		–
Machinery and equipment	15.6	18.9	31.1	11.4	-15.0		–
Business inventory change[1]	-0.2	0.3	-0.6	1.5	-2.6		–
Trade balance[1]	0.4	-0.7	-0.7	-1.6	4.7		–
Exports	10.0	9.6	9.6	2.0	1.0		–
Imports	9.4	12.0	12.1	6.0	-9.8		–
Current account balance							
(nominal $ billion)	-3.4	18.9	15.2	18.5	23.4		–
(percentage of GDP)	-0.4	1.8	1.5	1.8	2.2		–
Real personal disposable income	2.7	3.8	3.4	-0.1	7.8		–
Profits before taxes	23.7	23.4	7.1	7.5	10.4		–
Costs and prices (%, y/y)							
GDP price deflator	1.6	3.6	3.8	3.6	3.2		–
Consumer price index	1.7	2.7	2.4	2.7	3.1	3.0	Jan-2001
CPI – excluding food and energy	1.5	1.5	1.4	1.5	1.7	2.0	Jan-2001
Unit labour costs	0.5	2.4	2.5	2.4	2.7		
Wage settlements (total)	2.2	2.5	2.5	2.3	2.9	3.1	Dec-2000
Labour market							
Unemployment rate (%)	7.6	6.8	6.7	6.9	6.9	6.9	Jan-2001
Employment growth	2.8	2.6	1.7	1.0	3.0	0.1	Jan-2001
Financial markets (average)							
Exchange rate (cents U.S.)	67.32	67.34	67.56	67.47	65.55	65.02	6-Mar-2001
Prime interest rate (%)	6.44	7.27	7.33	7.50	7.50	6.75	7-Mar-2001

[1] Annualized change expressed as a percentage of GDP in the previous period.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Consumer spending growth flattens

Real consumer expenditure advanced modestly from its third-quarter level, rising 2.3%, half the pace in the previous quarter. Consistent with a shift in demand toward domestic products, spending on services grew more rapidly than in the previous quarter while that on import-intensive durables dropped 6.8%. Spending on motor vehicles fell sharply compared to the third quarter, when manufacturers had been offering incentives to boost vehicle sales.

Personal income growth was much stronger than in the third quarter. Labour income grew more robustly as employment growth quickened. Personal investment income jumped, partly due to federal pay equity interest disbursements. Further, real personal disposable income was up 7.8%, posting its largest increase since 1989, while real personal disposable income per capita rose to its highest level ever. The personal savings rate rose to 3.5% from 2.3% in the third quarter.

Business fixed investment falls

Business spending on plant and equipment in the fourth quarter was 9.3% less than in the third. Investment in import-intensive machinery and equipment fell 15.0% after rising 11.4% in the third quarter. Declines were widespread, including automobiles, trucks, other transportation equipment, telecommunications equipment and computers. However, non-residential construction, which is largely satisfied by domestic production, increased 4.4% after falling in the third quarter, with gains in building and engineering projects.

Residential investment edged down 0.5% in the fourth quarter following a gain of 7.9% in the third. Growth in new construction activity dipped with housing starts, dropping 0.8%. Ownership transfer costs registered a similar modest loss while spending on renovations was largely unchanged.

Inventory correction is underway

Inventory accumulation in the fourth quarter was much more modest than in the third, subtracting significantly from GDP growth. Business inventories increased $4.1 billion after rising $10.1 billion in the previous quarter. The smaller accumulation largely reflected a run-down of motor vehicle stocks and a more modest buildup among other manufactured goods. But with sales growth just below that of inventories, the inventory-to-sales ratio was up slightly from its record low in the third quarter.

Switch in domestic demand boosts Canadian production

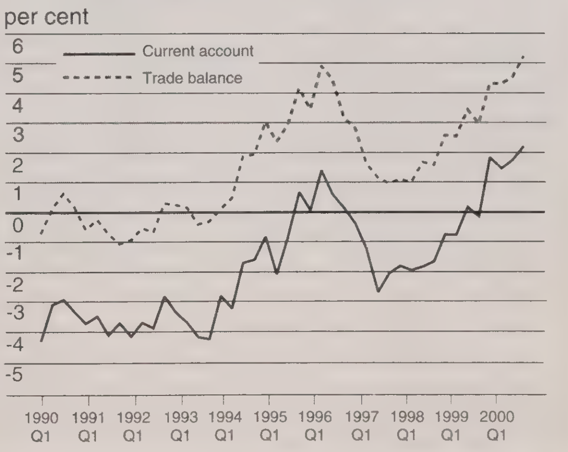
Domestic demand, while mostly unchanged in the fourth quarter, shifted toward Canadian-produced goods and services, pushing down real imports by 9.8%. The decline was largely in machinery and equipment, reflecting reduced business investment, and automotive products, consistent with lower motor vehicle sales in Canada and the United States.

Foreign demand for Canadian products, as reflected in real exports, grew more slowly than in the third quarter. While exports of machinery and equipment actually grew more strongly than in the previous quarter, other major categories saw declines that largely offset that gain. This is consistent with the further slowing of U.S. economic growth in the fourth quarter. In particular, there was a substantial decline in Canadian exports of automotive products, as motor vehicle sales fell over 25% in the United States in that quarter.

A record current account surplus

With real exports rising modestly and real imports falling substantially, the real trade balance doubled. The terms of trade, however, deteriorated as export prices rose less than import prices. These developments produced a $7.7-billion improvement in the nominal trade surplus relative to the third quarter and a new record level (Chart 2). However, a nearly $3-billion deterioration in the investment income deficit (including retained earnings) partially offset the gain in the trade surplus. Overall, the current account surplus rose to a record $23.4 billion, or 2.2% of nominal GDP. And the $18.9-billion surplus in 2000 (or 1.8% of nominal GDP) was also an annual record and a substantial improvement from deficits of 1.8% of nominal GDP in 1998 and 0.4% in 1999.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains subdued

Underlying price and cost pressures remain subdued. The implicit and chain price indices for GDP advanced in the fourth quarter to levels 3.2% and 4.4% higher than a year earlier. The size of these increases partly reflected the temporary impacts of higher energy prices. And while consumer price inflation was 3.0% in January on a year-over-year basis and down slightly from December, the increased pace in recent quarters is again largely due to higher energy prices. Underlying CPI inflation, which excludes food and energy, was 2.0% in January on a year-over-year basis.

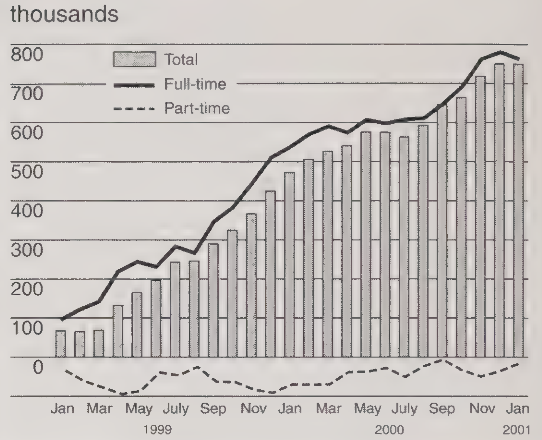
Labour productivity declined in the fourth quarter for the first time in over a year: output per employed person fell 0.4% while output per hour worked was down 0.6%. Nonetheless, labour productivity was nearly 2% higher than a year earlier. As a result, year-over-year unit labour cost growth rose modestly to 2.7%.

Pre-tax corporate profits increased for the ninth consecutive quarter and more quickly than in the third quarter, rising 10.4% to a level 13.9% above that of a year earlier. Gains were notable for the oil and gas extraction industry, reflecting energy price increases during the year, and for electronics and computer manufacturers, even though demand growth softened late in the year.

Unemployment remains low

Fourth-quarter employment growth picked up, rising 3.0% after gaining only 1.0% in the third quarter. While employment growth paused in January, nearly 325,000 net new jobs were created in 2000. The increase since the end of 1998 stands at over 750,000 (Chart 3). Full-time jobs have accounted for the total gain. The unemployment rate in January 2001 was 6.9%.

Chart 3
Cumulative employment growth since December 1998



The Canadian dollar relatively stable

After trading below 65 cents U.S. in late November, the value of the Canadian dollar rose to nearly 67 cents U.S. in early February before retrenching and closing at 65.02 cents U.S. on March 6.

In response to weakening economic growth, in January the U.S. Federal Reserve twice lowered its target for the Federal Funds rate by 50 basis points each time. The Bank of Canada lowered its Bank Rate by 25 basis points on January 23 and another 50 basis points on March 6. Long-term interest rates in the United States have remained stable since the cuts to the Federal Reserve's target rate, although they are somewhat below those in late November. Short rates have dropped more than one percentage point since late November. Long rates have also been stable in Canada while short rates have fallen less than in the United States. As a result, interest rates in Canada are generally above those in the United States, although the spread for short rates is small.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2001

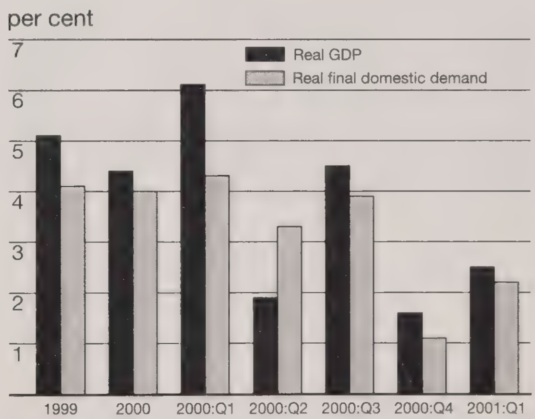
OVERVIEW

- In the first quarter of 2001 real gross domestic product (GDP) grew 2.5%. The increase was above that in the fourth quarter (1.6%) but below the 4.4% annual growth in 2000.
- Growth was supported by stronger real final domestic demand, primarily in the areas of consumer spending and residential construction. Also boosting real GDP was a shift in demand to Canadian-made products, as imports dropped 11.0%.
- While the volume of exports fell 5.7%, reflecting weakening demand from the United States, nominal exports rose, led by higher energy prices. That pushed the current account surplus to a record $50.9 billion, or 4.6% of nominal GDP.
- Employment growth resumed, with a gain of 55,000 net new jobs in March and April after a loss in February and no gain in January. More than 355,000 net new jobs have been created since the end of 1999. The unemployment rate in April 2001 was 7.0%.

Modest real GDP growth continues

In the first quarter of 2001 the Canadian economy continued its more modest expansion after strong growth in the previous two years. This was the 36th consecutive quarterly gain. Real final domestic demand increased 2.2% after a gain of 1.1% in the fourth quarter, and shifted somewhat toward Canadian-produced goods and services. These factors boosted Canadian output (Chart 1). However, increased demand was partly satisfied from inventories, resulting in reduced inventory accumulation. That plus lower foreign demand moderated the pace of growth.

Chart 1
Growth in real GDP and real final domestic demand



Note: Final domestic demand is spending by Canadians on goods, services, housing, plant and equipment.

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, May 31, 2001.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1999	2000	2000:Q3	2000:Q4	2001:Q1	Most recent	
Real gross domestic product	5.1	4.4	4.5	1.6	2.5		–
Final domestic demand	4.1	4.0	3.9	1.1	2.2		–
Government expenditure							
Goods and services	2.6	2.2	1.2	3.5	4.8		–
Gross fixed capital	12.3	7.6	7.0	2.2	-3.6		–
Consumer expenditure	3.4	3.6	5.2	1.2	3.6		–
Residential investment	5.3	2.7	9.7	3.9	6.4		–
Business fixed investment	7.2	8.1	-0.3	-3.5	-7.5		–
Non-residential construction	1.8	5.3	-0.5	2.7	0.5		–
Machinery and equipment	10.5	9.7	-0.1	-7.0	-12.0		–
Business inventory investment ($ billion)	4.6	9.2	10.4	4.5	1.9		–
Exports	9.9	7.6	1.2	-0.1	-5.7		–
Imports	7.3	8.1	-0.3	-9.1	-11.0		–
Current account balance							
(nominal $ billion)	1.7	26.9	27.6	34.2	50.9		–
(percentage of GDP)	0.2	2.5	2.6	3.2	4.6		–
Real personal disposable income	3.3	3.5	-0.4	6.7	5.4		–
Profits before taxes	21.9	21.8	12.9	7.5	16.2		–
Costs and prices (%, y/y)							
GDP price deflator	1.4	3.7	3.5	3.4	3.6		–
Consumer price index	1.7	2.7	2.7	3.1	2.8	3.6	Apr-2001
CPI – excluding food and energy	1.5	1.5	1.5	1.7	1.9	2.1	Apr-2001
Unit labour costs	0.8	2.3	2.0	2.7	2.8		
Wage settlements (total)	2.2	2.5	2.3	2.9	3.6	3.8	Mar-2001
Labour market							
Unemployment rate (%)	7.6	6.8	6.9	6.9	7.0	7.0	Apr-2001
Employment growth	2.8	2.6	1.0	3.0	0.9	2.0	Apr-2001
Financial markets (average)							
Exchange rate (cents U.S.)	67.32	67.34	67.47	65.55	65.47	64.70	30-May-2001
Prime interest rate (%)	6.44	7.27	7.50	7.50	7.08	6.25	30-May-2001

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Consumer spending strengthens

Real consumer expenditure advanced a healthy 3.6% in the first quarter, three times its pace in the previous quarter, and dominated the gain in final domestic demand. Spending growth on durables surged 11.6%, with strong gains in automotive products, furniture and appliances, while that on services eased somewhat.

Personal income increased robustly, rising more than in the fourth quarter, with solid increases in all major categories except investment income. Labour income rose more robustly than in the previous quarter even though employment growth slowed, as average hours worked per week jumped. Real personal disposable income was up over 5% and in per capita terms increased to its highest level ever.

With personal disposable income growth outpacing that of nominal consumer spending, the personal savings rate rose to 4.4% from 4.0%.

Business fixed investment continues to fall

Business spending on plant and equipment was 7.5% less in the first quarter than in the fourth, the third consecutive decline. Investment in import-intensive machinery and equipment fell 12.0% after dropping 7.0% in the previous quarter. While they were widespread, the declines were especially evident in transportation and telecommunications equipment. However, non-residential construction, which is largely satisfied by domestic production, increased a modest 0.5%, with growth in engineering projects more than offsetting a decline in building projects.

Residential investment remains strong

Residential investment, which is also largely satisfied by domestic sources, jumped 6.4% in the first quarter following a gain of 3.9% in the fourth. Growth in new construction activity rose sharply with housing starts, gaining about 16%. Ownership transfer costs registered a healthy gain while spending on renovations declined.

Businesses are correcting inventories

Inventory accumulation in the first quarter was lower than in the fourth and subtracted from GDP growth. Business inventories increased $1.9 billion after rising $4.5 billion in the previous quarter. This largely reflected a need to reduce stocks in the automotive sector.

Imports fall more than exports

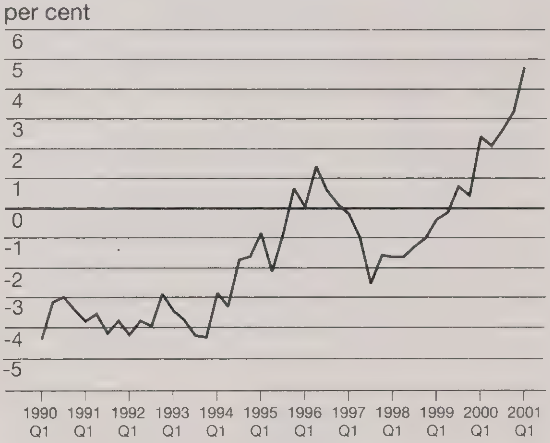
With domestic demand shifting toward Canadian-produced goods and services, real imports dropped 11.0% in the first quarter. This decline was largely in automotive products, consistent with the inventory correction in that sector, and machinery and equipment, reflecting reduced business investment.

Foreign demand for Canadian goods decreased in the first quarter. Exports of machinery and equipment and automotive products took the brunt of the 5.7% fall. This is consistent with the slowing of U.S. economic growth and the significant inventory correction in that country.

Another record current account surplus

With real exports falling less than real imports and the terms of trade improving (export prices rose more than import prices due largely to higher energy prices), the nominal trade surplus improved by more than $15 billion from its fourth-quarter level, achieving another new record. This boosted the current account surplus by over $16 billion to a record $50.9 billion, or 4.6% of nominal GDP (Chart 2), a sharp improvement from the $12-billion current account deficit in 1998.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains subdued while labour costs rise

Underlying price and cost pressures remain subdued even though the chain price index for GDP advanced 5.0% in the first quarter to a level 3.6% higher than a year earlier. The size of the increase reflects the impact of higher export prices, in particular energy prices. Domestic inflation remains more subdued. While consumer price inflation was 3.6% in April on a year-over-year basis, up sharply from that in March, the increased pace in recent quarters is again largely due

to higher energy prices. Underlying CPI inflation, which excludes food and energy, was 2.1% in April on a year-over-year basis.

Labour productivity registered a mixed result in the first quarter: output per employed person rose 1.6% while output per hour worked dropped 0.8%. As a result of that and strong wage growth, labour costs per unit of output rose 3.0% to a level 2.8% higher than a year earlier.

Energy boosts corporate profits

Pre-tax corporate profits increased for the 11th consecutive quarter and at double the pace in the fourth quarter, gaining 16.2% to a level 11.2% above that of a year earlier. Gains were notable in the energy sector, reflecting increased energy prices and energy rebate programs for businesses in Western Canada.

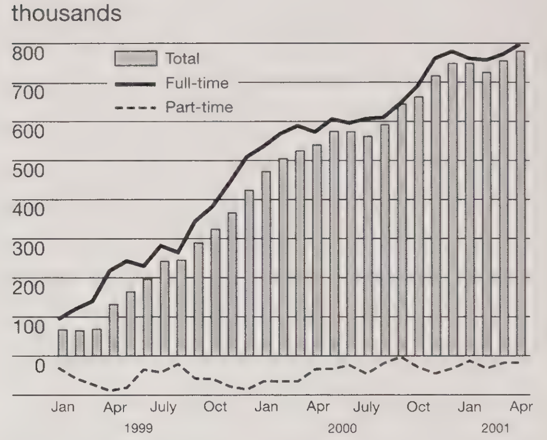
Unemployment remains low

First-quarter employment growth slowed, rising 0.9% after gaining 3.0% in the fourth quarter. Nonetheless, employment growth has been strong in recent years. With nearly 325,000 net new jobs created in 2000 plus another 55,000 added in March and April, the increase since the end of 1998 stands at over 780,000 (Chart 3). Full-time jobs have accounted for the total gain. The unemployment rate in April 2001 was 7.0%.

Short-term interest rates fall

In response to weakening economic growth, the U.S. Federal Reserve has lowered its target for the Federal Funds rate five times for a total of 250 basis points during 2001. The most recent change was a 50-basis-point decline on May 15. The Bank of Canada lowered its Bank Rate four times over the same period by a total of 125 basis points, with the most recent change a 25-basis-point decline on May 29.

Chart 3
Cumulative employment growth since December 1998



Long-term interest rates in the U.S. have risen over the last two months despite the cuts to the Federal Reserve's target rate. They are similar to those in late November. Short rates have dropped more than 200 basis points since the beginning of the year and about 250 basis points since late November. Long rates have risen as much or more in Canada than in the U.S. while short rates have fallen significantly less than in that country. As a result, interest rates in Canada are generally above those in the U.S.

The widening gap with U.S. interest rates has helped the Canadian dollar to recover from recent weakness. After trading at about 65 cents U.S. in early March, the value of the Canadian dollar dropped in early April to near its record low close of 63.31 cents U.S. However, it has since rebounded and closed at 64.70 cents U.S. on May 30.

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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 2001

OVERVIEW

- In the second quarter of 2001 real gross domestic product (GDP) grew 0.4%, following a 2.0% gain in the first quarter.
- Declining foreign demand, notably from the United States, slowed the pace of growth, as real exports dropped 3.1%.
- A slowing pace of real final domestic demand also contributed to the moderating pace of growth while an inventory accumulation helped to limit the slowdown. Imports satisfied part of the higher domestic demand, further restraining Canadian output growth.
- Falling world energy prices dragged down export prices and reinforced the negative impact of real trade movements on the nominal trade balance. This contributed to the $14.5-billion drop in the current account surplus to $39.5 billion, or 3.6% of nominal GDP.
- Employment grew 1.1% in the second quarter overall but registered slight losses in June, July and August. Nonetheless, over 330,000 net new jobs have been created since the end of 1999. The unemployment rate was 7.2% in August 2001, up from 7.0% in July.

Real GDP growth slows

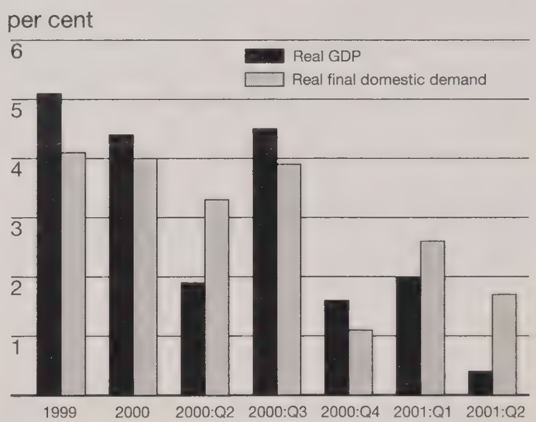
The modest gain in the second quarter represented the 37th consecutive quarter of output growth. Real final domestic demand growth slowed to 1.7% from 2.6% in the first quarter. This, combined with higher imports, moderated the need to boost Canadian production (Chart 1).

Consumer spending growth moderates

Real consumer expenditure advanced 1.1%, a slower pace than in the previous quarter. Spending growth on durables slowed dramatically to 2.1%, with all major categories contributing, while that on

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, September 7, 2001.

Chart 1
Growth in real GDP and real final domestic demand



Note: Final domestic demand is spending by Canadians on goods, services, housing, plant and equipment.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1999	2000	2000:Q4	2001:Q1	2001:Q2	Most recent	
Real gross domestic product	5.1	4.4	1.6	2.0	0.4		–
Final domestic demand	4.1	4.0	1.1	2.6	1.7		–
Government expenditure							
Goods and services	2.6	2.2	3.5	3.0	3.2		–
Gross fixed capital	12.3	7.6	2.2	1.5	-4.5		–
Consumer expenditure	3.4	3.6	1.2	3.4	1.1		–
Residential investment	5.3	2.7	3.9	6.5	0.4		–
Business fixed investment	7.2	8.1	-3.5	-2.6	3.8		–
Non-residential construction	1.8	5.3	2.7	2.5	2.1		–
Machinery and equipment	10.5	9.7	-7.0	-5.6	4.8		–
Business inventory investment ($ billion)	4.6	9.2	4.5	-0.1	1.6		–
Exports	9.9	7.6	-0.1	-4.7	-3.1		–
Imports	7.3	8.1	-9.1	-9.6	2.1		–
Current account balance							
(nominal $ billion)	1.7	26.9	34.2	54.0	39.5		–
(percentage of GDP)	0.2	2.5	3.2	4.9	3.6		–
Nominal personal income	4.8	6.1	6.0	7.4	-0.2		–
Nominal personal disposable income	5.0	5.6	9.3	6.5	-1.3		–
Real personal disposable income	3.3	3.5	6.8	5.7	-5.6		–
Profits before taxes	21.9	21.8	7.5	13.1	-6.4		–
Costs and prices (%, y/y)							
GDP price deflator	z	3.7	3.4	3.7	2.5		–
Consumer price index	1.7	2.7	3.1	2.8	3.6	2.6	Jul-2001
CPI – excluding eight most volatile items	1.3	1.3	1.5	1.8	2.3	2.4	Jul-2001
Unit labour costs	0.8	2.3	2.7	3.2	1.7		
Wage settlements (total)	2.2	2.5	2.9	3.5	2.9	3.2	Jun-2001
Labour market							
Unemployment rate (%)	7.6	6.8	6.9	7.0	7.0	7.2	Aug-2001
Employment growth	2.8	2.6	3.0	0.9	1.1	-0.6	Aug-2001
Financial markets (average)							
Exchange rate (cents U.S.)	67.32	67.34	65.55	65.47	64.89	64.22	6-Sep-2001
Prime interest rate (%)	6.4	7.3	7.5	7.1	6.3	5.75	6-Sep-2001

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

services also eased. As well, consumers spent less on non-durables than they did in the first quarter.

Personal income was roughly unchanged from its first-quarter level. Transfers from government dropped sharply after being temporarily inflated in the first quarter by federal energy relief payments. In addition, labour income rose less robustly than in the previous quarter as employees worked, on average, fewer hours per week than in the first quarter. As a result, personal disposable income declined even though there was only a modest advance in income taxes paid to government. This, together with rising spending by households on goods and services, caused the personal savings rate to fall to 2.8% from 4.6%, matching the record low in the third quarter of 2000 (Chart 2).

Residential investment growth flattens

Residential investment, which is largely satisfied through domestic production, increased a very modest 0.4% in the second quarter following a gain of 6.5% in the first. A noticeably stronger house resale market offset declines in construction activity associated with housing starts and renovations.

Business fixed investment grows

Following three consecutive declines, business spending on plant and equipment rose 3.8% in the second quarter. Investment in import-intensive machinery and equipment rose 4.8% after falling 5.6% in the previous quarter. The gains were especially evident in transportation equipment and software purchases. Non-residential construction, which is largely satisfied by domestic production, increased a more modest 2.1%, with increased spending on both building and engineering projects, notably by the oil and gas industry.

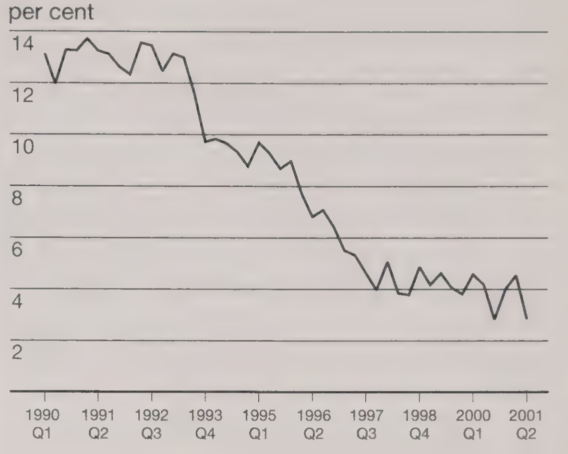
Businesses accumulate inventories

A business inventory accumulation of $1.6 billion in the second quarter followed a slight rundown in the first quarter, adding to real GDP growth. The increase in the second quarter was partly due to a rise in energy inventories while the slight drop in the first quarter was a response to a need to reduce stocks of automotive and high-technology products.

Exports fall while imports rise

Foreign demand for Canadian goods and services weakened in the second quarter, with real exports declining 3.1%. Exports of energy products and machinery and equipment, especially high-technology products, took the brunt of the fall. This is consistent with slowing U.S. growth and the inventory rundown in that country in the first half of the year.

Chart 2
Personal savings rate



Real imports rose 2.1% in the quarter, with particular strength in energy and automotive products. However, a decline in non-automotive machinery and equipment imports restrained import growth.

Current account surplus falls

With real exports falling, real imports rising and the terms of trade worsening (export prices fell while import prices rose), the nominal trade surplus dropped $10.9 billion from the first-quarter level. Along with deteriorations in net investment income and net transfers between Canadians and non-residents, this lowered the current account surplus by $14.5 billion from its record level in the first quarter to $39.5 billion, or 3.6% of GDP. However, this remains a sharp improvement from the deficits registered throughout most of the 1990s.

Inflation remains subdued

Underlying price and cost pressures remained subdued in the second quarter. Falling world energy prices moderated the growth of the GDP deflator. This most comprehensive measure of inflation dropped to a year-over-year increase of 2.5% from 3.7% in the first quarter. Domestic inflation also remained subdued, with consumer price

inflation moderating to 2.6% in July on a year-over-year basis from 3.3% in June. Core CPI inflation, which excludes the eight most volatile items, was 2.4% in July on a year-over-year basis.

Labour productivity registered a mixed result in the second quarter: output per employed person fell a modest 0.6% while output per hour worked jumped 7.5%. With that, labour income growth exceeded output growth, modestly boosting labour costs per unit of output to a level 1.7% higher than a year earlier, down from a year-over-year increase of 3.2% in the first quarter.

Corporate profits decline

Corporate profits decreased 6.4% following 11 consecutive quarterly gains. The decrease brought profits to 6.5% above the level of a year earlier. Declining profits were especially notable in the energy sector, reflecting falling prices. As well, manufacturers' profits slid as demand softened, especially for electronic and computer products.

Unemployment rate rises slightly

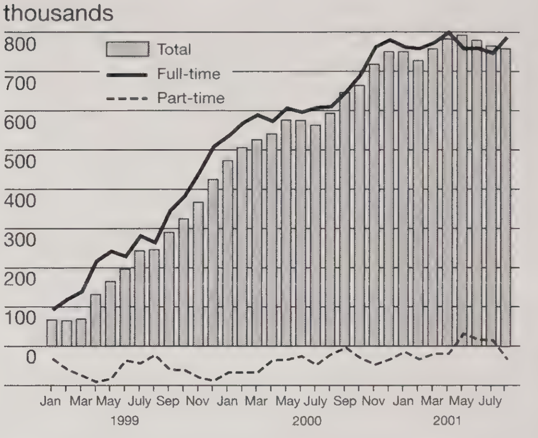
In the second quarter, employment growth remained moderate, rising 1.1% after a gain of 0.9% in the first quarter. Weak economic growth resulted in moderate job losses in June, July and August, with the unemployment rate in August standing at 7.2%, up from 7.0% in July. The modest employment gains to date in 2001 have been in full-time jobs.

Taking a longer view, this sluggishness follows a period of strong employment growth, with 750,000 net new jobs created during 1999 and 2000 (Chart 3), with gains in those years entirely in full-time jobs.

Interest rates fall

In response to weakening economic growth, the U.S. Federal Reserve has lowered its target for the Federal Funds rate seven times during 2001 for a total decline of 3 percentage points. The most recent change was a 25-basis-point decline on August 21. The Bank of Canada lowered its Bank Rate six times over the same period by a total of 175 basis points, with the most recent change a 25-basis-point drop on August 28.

Chart 3
Cumulative employment growth since December 1998



Market interest rates in the United States have also fallen over the last three months. The drop in long-term rates has reduced them to near levels at the beginning of 2001 while that in short rates has been more or less in line with the reductions in the Federal Funds target rate. Canadian interest rates generally moved with those in the United States in recent months and so remain above them, with the spread on short rates falling slightly and that on long rates rising modestly.

With both the Canadian and U.S. economies registering subdued growth and with spreads in interest rates in the two countries changing little in recent months, the Canadian dollar has been trading between 64 cents U.S. and 66 cents U.S., closing at 64.22 cents U.S. on September 6.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Mostafa Askari at (613) 992-3055.
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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE DECEMBER 2001

OVERVIEW

- In the third quarter of 2001 real gross domestic product (GDP) shrank 0.8%, following a 0.6% gain in the second quarter. This first quarterly decline since early 1992 was partly the result of the September 11 terrorist attacks on the United States.
- Declining foreign demand from both the United States and overseas resulted in a drop of 7.7% in real exports.
- Consumer expenditure dipped 0.3% in the third quarter.
- Businesses reduced inventories by $4.9 billion, subtracting over 2 percentage points from real GDP growth.
- Falling world energy prices lowered export prices, contributing to the $13.9-billion drop in the current account surplus to $22.1 billion.
- Employment fell 0.5% in the third quarter despite a small gain in September. Labour market signals were mixed in October and November. In November there was a modest gain in employment, but the unemployment rate rose to 7.5% from 7.3% in October.

Real GDP falls

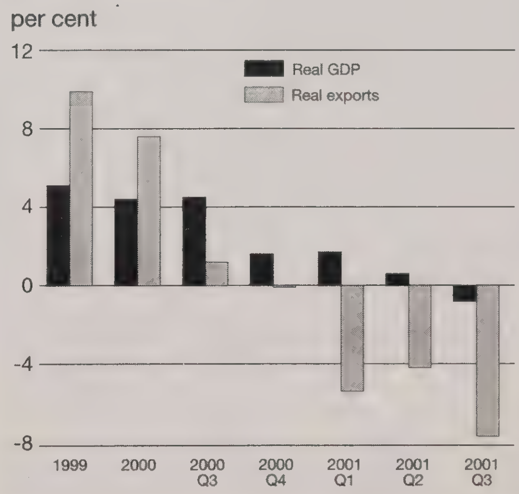
Real GDP declined in the third quarter after 37 consecutive gains (Chart 1). Falling foreign demand and a decrease in business inventories were the major contributors to this.

Exports and imports both drop

The world economic slowdown reduced trade flows in the third quarter. As well, trade was disrupted in the weeks immediately after the September 11 terrorist attacks on the United States.

Consistent with slowing world growth, foreign demand for Canadian goods and services continued to decline in the third

Chart 1
Growth in real GDP and real exports



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, December 7, 2001.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	1999	2000	2001:Q1	2001:Q2	2001:Q3	Most recent	
Real gross domestic product	5.1	4.4	1.7	0.6	-0.8		–
Final domestic demand	4.1	4.0	2.7	1.7	1.1		–
Government expenditure							–
Goods and services	2.6	2.2	2.8	4.7	1.6		–
Gross fixed capital	12.3	7.6	1.7	-5.0	1.6		–
Consumer expenditure	3.4	3.6	3.6	0.6	-0.3		–
Residential investment	5.3	2.7	5.9	1.1	4.2		–
Business fixed investment	7.2	8.1	-2.6	3.8	5.8		–
Non-residential construction	1.8	5.3	1.2	1.3	-5.1		–
Machinery and equipment	10.5	9.7	-4.8	5.4	12.8		–
Business inventory investment ($ billion)	4.6	9.2	-0.2	0.5	-4.9		–
Exports	9.9	7.6	-5.4	-4.2	-7.7		–
Imports	7.3	8.1	-9.3	-1.3	-7.8		–
Current account balance							
(nominal $ billion)	1.7	26.9	54.4	36.0	22.1		–
(percentage of GDP)	0.2	2.5	5.0	3.3	2.1		–
Nominal personal income	4.8	6.1	6.5	-0.4	1.9		–
Nominal personal disposable income	5.0	5.6	5.2	-1.0	3.5		–
Real personal disposable income	3.3	3.5	4.8	-5.8	2.3		–
Profits before taxes	21.9	21.8	7.1	-14.7	-45.0		–
Costs and prices (%, y/y)							
GDP price deflator	1.4	3.7	3.7	1.9	0.2		–
Consumer price index	1.7	2.7	2.8	3.6	2.7	1.9	Oct-2001
CPI – excluding eight most volatile items	1.3	1.3	1.8	2.3	2.4	2.2	Oct-2001
Unit labour costs	0.8	2.3	3.2	1.5	2.5		
Wage settlements (total)	2.2	2.5	3.5	2.9	3.4	3.5	Sep-2001
Labour market							
Unemployment rate (%)	7.6	6.8	7.0	7.0	7.1	7.5	Nov-2001
Employment growth	2.8	2.6	0.9	1.1	-0.5	1.1	Nov-2001
Financial markets (average)							
Exchange rates (cents U.S.)	67.3	67.3	65.5	64.9	64.7	63.59	6-Dec-2001
Prime interest rate (%)	6.4	7.3	7.1	6.3	5.7	4.0	6-Dec-2001

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

quarter. Real exports declined 7.7%, led by reductions in energy products, automotive products and machinery and equipment, especially high-technology products. Exports of services dropped by 16.7%, in part due to a sharp 26.4% reduction in real spending by non-residents on travel in Canada.

Meanwhile, real imports fell 7.8%, with widespread declines as Canadian domestic demand growth slowed.

Consumer spending dips

Real consumer expenditure fell 0.3% in the third quarter. Spending on all major categories of goods fell, with pronounced declines for durables, especially automotive products. Outlays for services rose 1.9%.

Personal income increased 1.9%, boosted by an increase in transfers from government. Wages and salaries rose, as a modest increase in hours worked per week offset losses in

employment. Meanwhile, income taxes fell, leading to a 3.5% increase in nominal personal disposable income. The personal savings rate increased to 3.3% from the record low 2.6% of the previous quarter.

Businesses cut inventories

Businesses lowered their inventories by $4.9 billion in the third quarter following a modest accumulation in the second. This subtracted over 2 percentage points from real GDP growth. The September 11 attacks in the United States may have influenced the level of inventories held in the third quarter.

Residential investment rises

Residential investment, which is largely satisfied through domestic production, rose 4.2% in the third quarter, the fifth consecutive increase, with gains coming from the house resale market, renovations and new construction despite a drop in housing starts during the quarter.

Business fixed investment increases

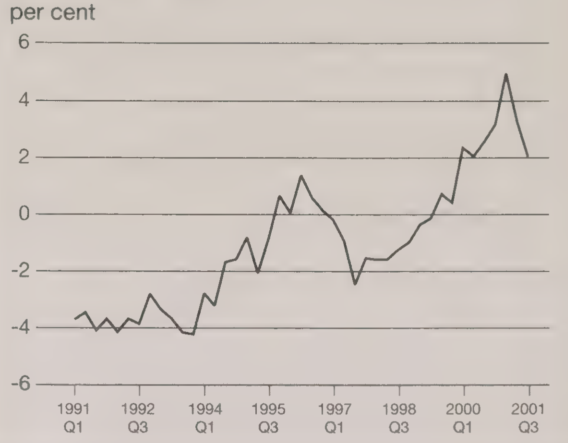
Business spending on plant and equipment rose 5.8% in the third quarter, following a gain of 3.8% in the second. Investment in import-intensive machinery and equipment increased 12.8% after rising 5.4% in the previous quarter. The gain was boosted by an increase in transportation equipment, including a floating drilling rig for the Nova Scotia energy sector. Excluding non-motor vehicle transportation equipment, investment in machinery and equipment declined in the third quarter.

Non-residential construction, which is largely satisfied by domestic production, decreased 5.1% following three consecutive gains. This reflected decreased spending on both building and engineering projects.

Current account remains in surplus

A sharp drop in the price of exported energy products contributed to a $17.1-billion reduction in the nominal trade surplus from the second-quarter level. As this deterioration in the trade surplus was partly offset by a $3.5-billion improvement in the investment income deficit, the current account surplus fell by $13.9 billion from its second-quarter level to $22.1 billion, or 2.1% of GDP (Chart 2). However, this remains a sharp improvement from the deficits registered throughout most of the 1990s.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains subdued

Underlying price and cost pressures remained subdued in the third quarter. Falling world energy prices led to a substantial decline in the GDP deflator. This comprehensive measure of inflation dropped 4.8% in the third quarter, bringing the year-over-year increase to 0.2% from 1.9% in the second quarter. Consumer price inflation also remained subdued at 1.9% in October. Core CPI inflation, which excludes the eight most volatile items, was 2.2% in that month.

Labour productivity declined in the third quarter: output per employed person fell a modest 0.3% while output per hour worked dropped 1.1%. And labour costs per unit of output were 2.5% higher than a year earlier, compared to 1.5% in the second quarter.

Corporate profits fall

Corporate profits decreased 45%, the second consecutive drop following 11 consecutive quarterly gains. This brought profits to 14.3% below the level of a year earlier. Declining profits were particularly notable in the energy sector, reflecting falling prices, and manufacturing, as demand softened, especially for automotive and electronic and computer products.

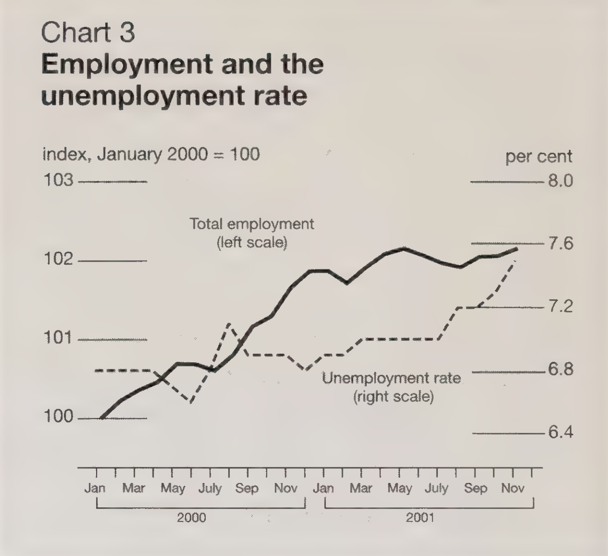
Unemployment rate edges up

In tandem with falling foreign demand, signs of weakness appeared in the Canadian labour market early in 2001. This was particularly evident in export-oriented manufacturing industries. Total employment has remained virtually unchanged so far during 2001 (Chart 3). It declined 0.5% in the third quarter, after rising 1.1% in the second. Employment increased modestly in October and November, with a gain in part-time jobs offsetting loses in full-time employment.

The unemployment rate has risen modestly during the year. It increased to 7.5% in November from 7.3% in October and a recent low of 6.6% in June 2000.

Interest rates fall further

In response to economic weakness, the U.S. Federal Reserve has lowered its target for the Federal Funds rate 10 times during 2001 for a total decline of 450 basis points. The most recent change was a 50-basis-point decline on November 6. The Bank of Canada has lowered its Bank Rate nine times over the same period by a total of 350 basis points, including a 50-basis-point drop on November 27.



Short-term market interest rates in the United States have fallen roughly in line with the reductions in the Federal Funds target rate over the last three months. However, after initially dipping, long-term rates have risen somewhat, although not back to the levels of late August. Canadian interest rates have generally moved with those in the United States in recent months.

The value of the Canadian dollar fell to an all-time low close of 62.37 cents against the American dollar on November 9. It has since rebounded to close at 63.59 cents U.S. on December 6.

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